In the

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1258

WILLIAM BLACKIE, et al.,

Petitioners,

v.

LEONARD BARRACK, et al.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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Petitioners respectfully pray that this Court grant a writ of certiorari to review the Judgment* of the United States Court of Appeals for the Ninth Circuit, affirming, on discretionary interlocutory appeal under 28 U.S.C. § 1292(b), and on the basis of

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*The Judgment on the discretionary appeal which was heard and is here sought to be reviewed is designated as No. 74-2648, and appears in the Appendix at p. A-45. Other Judgments in the case dismissing the direct appeals, designated Nos. 74-2141, 74-2167, 74-2341 and 74-2466, are treated in companion petitions for certiorari, and these petitioners adopt the arguments set forth therein.

new substantive rules for the proof of liability and damages in cases under Section 10(b) of the Securities Exchange Act of 1934, the conditional certification by the United States District Court for the Northern District of California, of a single class of all purchasers of a company's securities over a 27-month period, as plaintiffs in eight overlapping class actions for numerous, disparate and changing alleged misrepresentations which plaintiffs claim inflated each of their various respective purchase prices in varying amounts at diverse times during the period.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Ninth Circuit (by Circuit Judge Koelsch and joined in by Circuit Judges Tuttle and Browning) is reported at 524 F.2d 891, and appears in the Appendix hereto at pages A-10 to A-44.* The Opinion of the United States District Court for the Northern District of California (by Judge Williams), not reported for publication, also appears in the Appendix hereto at pages A-1 to A-9.

JURISDICTION

The date of the Judgment of the United States Court of Appeals for the Ninth Circuit and the date of its entry was September 25, 1975. A timely petition for rehearing and rehearing *in banc* was denied by order filed on December 16, 1975. This petition for a writ of certiorari was filed within 90 days of that date. The order denying rehearing appears in the Appendix hereto at pages A-46 to A-47. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

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*All page references, unless otherwise indicated, are to the Ninth Circuit's Opinion as set forth in the Appendix. This petition is directed to pp. A-24 ff.; the first part of the Opinion, pp. A-10 to A-23, deals with the issue of direct appealability.

QUESTIONS PRESENTED

May a federal court, consistently with this Court's *Blue Chip Stamps* opinion,* the Enabling Act** and the parties' rights to due process,*** restrict defendants' substantive proof against liability and expand plaintiffs' measure of damages for claims under Section 10(b) of the Securities Exchange Act of 1934, in order to certify a single conditional class of all purchasers of a company's securities over a 27-month period, claiming an aggregation of numerous, disparate and changing alleged misrepresentations in connection with their respective purchases:

(1) Where adoption of new substantive rules of proof of Section 10(b) claims favoring plaintiffs and restricting defendants' substantive rights to prove their defenses against liability are necessary in order to satisfy the requirements of Rule 23(b)(3) for predominance and manageability?

(2) Where inevitable antagonisms of interest and resulting inadequacy of representation and untypicality of claims as between different groups in the class arising from admitted interim corrective reports, changing prices, and substantial sales by class members during the period are only partly resolved by enlarging the substantive rules as to the measure of damages, and where absent class members with significantly different interests are not represented at all?

(3) Where separate and distinct claims of component groups within the class are fused into one mass class claim by determinations that "common course of conduct" to violate Section 10(b) in different respects at diverse times is a common question of fact and general principles of law are a common question of law?

**Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

**28 U.S.C. § 2072.

***United States Constitution, Amendment V.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

The Constitutional provision involved is Amendment V of the United States Constitution.

The statutes involved are: Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and the Enabling Act (28 U.S.C. § 2072).

The rules involved are: Rule 23 of the Federal Rules of Civil Procedure and Rule 10b-5 promulgated by the Securities and Exchange Commission (17 C.F.R. § 240.10b-5).

Each of the above is set out verbatim in the Appendix hereto at pages A-48 to A-53.

STATEMENT OF THE CASE

This litigation began in the Eastern District of Pennsylvania in January, 1972, as a purported class action on behalf of all purchasers of Ampex securities from May 2, 1970 to January 12, 1972 against Ampex Corporation, its directors, and Touche Ross & Co., its independent auditors. Plaintiffs claimed violations of Sections 10(b) and 13(a) of the Securities Exchange Act of 1934 by diverse and general alleged misrepresentations and omissions in annual and quarterly reports, SEC filings, press releases and other documents, in which defendants allegedly overstated earnings, inventories and other assets, buried expenses for research and development, misrepresented current ratio, misstated accounts and notes receivable, and failed to establish reserves for doubtful accounts, to write off certain unspecified assets and to report the proposed discontinuation of certain unspecified product lines. Jurisdiction was invoked under Section 27 of the Securities Exchange Act and under 28 U.S.C. §§ 1331 and 1337. The action was transferred to the Northern District of California before the Honorable Spencer Williams, who consolidated it for pre-trial with seven other class actions alleging some or all of the same types of misrepresentations in various reports for differing and

overlapping periods. Various complaints in intervention were allowed. Judge Williams also appointed David Berger, Esq., and Leonard Barrack, Esq., counsel in the original *Barrack* action, as lead counsel. Messrs. Berger and Barrack also directly represent most of the other plaintiff class representatives and intervenors.

By amendment, the alleged class was extended from January 12 to August 3, 1972, and new allegations were added based on events in that additional seven-month period, which included further announcements in February and March, 1972, concerning losses by Ampex. Plaintiffs' complaints made no allegation of any self-dealing or personal enrichment by defendants except for a Section 10(b) derivative claim against defendant Roberts in a relatively small amount, which was dismissed on the ground that Ampex was not a purchaser. In January, 1974, defendants moved for partial summary judgment against Leonard Barrack, Pearl Singer and Selma Molder in their capacity as executors of the Estate of Sylvia Barrack, the class representative, on the ground that she individually could not have any claim for alleged misrepresentations after her purchase of her 100 shares of Ampex stock in April, 1971, fifteen months prior to the end of the purported class period. The motion was denied. Defendants have provided plaintiffs with extensive discovery, mainly through production of tens of thousands of documents and through answers to interrogatories, which have been provided both before and after appeal.

The District Court certified the alleged class with regard to claims under Section 10(b) conditionally and "subject to adjustments by further order" of the Court. The claims under Section 13(a) were not certified for class treatment on the ground that they could proceed only under Section 18(a) requiring individual, subjective reliance which would necessarily defeat commonness of issues of law or fact. On motion for reconsideration of the class certification, Judge Williams *sua sponte* certified his class certification order to the Court of Appeals for the Ninth Circuit under 28 U.S.C. § 1292(b) for defendants who had moved for reconsidera-

tion, but not others. The Ninth Circuit accepted the discretionary appeals and considered them together with direct appeals.

The size of the class for the 27-month period is estimated to be upwards of 100,000 investors, who purchased 21,000,000 shares of common stock and $50,000,000 face amount of debentures in approximately 120,000 transactions. During the period there were 2 annual reports, 7 quarterly interim financial statements, 469 press releases and 119 SEC filings. In their answering brief on appeal (at p. 37, f/n. 26), however, plaintiffs for the first time stated that:

> "This case, after discovery, will probably involve at most 46 deceptive documents over a 27-month period, including press releases and SEC filings along with the two annual reports and seven interim financial statements, see n. 1, *supra. The latter 9 documents are the heart of the plaintiffs' case, as these set forth (and the secondary documents merely repeat) the deceptive financial results.*" [Emphasis added.]

An estimated 38,000 purchasers sold their securities throughout the period, during which prices and volume fluctuated materially.

REASONS FOR GRANTING THE WRIT*

The Judgment of the Ninth Circuit violated (I) the holding and the policy of the *Blue Chip Stamps* case with regard to the substantive scope of Section 10(b) claims, (II) the provisions of the Enabling Act against the alteration of substantive rights in application of the Federal Rules of Civil Procedure, and (III) the defendants' due process rights to defense and the plaintiff class members' due process rights to representation. The reasons are as follows:

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*An additional reason for granting the writ, not treated herein, but treated by other petitioners, is that the Judgments of the Ninth Circuit are in conflict with the law of the Second Circuit on the direct appealability of the certification of a class.

I. Blue Chip Stamps Is Undermined by the Ninth Circuit's Judgment and Is Not Considered.

The Ninth Circuit's Judgment approved conditional certification of a single class for prosecution of diverse claims under Section 10(b): (A) by devising new judicial rules to facilitate plaintiffs' proof of liability and to limit severely defendants' proof in defense, in order to support the requirements of predominance and manageability under Rule 23(b)(3), F.R.Civ.P.; (B) by adopting new and expansive rules as to the measure of damages, in order to avoid inevitable conflicts among class members preventing fair and adequate representation under the Rule; and (C) by fusing separate and distinct Section 10(b) claims for component parts of the alleged class into an undifferentiated mass claim for the entire class, provable and remediable one for all, and all for one, by means of implausible common questions, all contrary to the *Blue Chip Stamps* case.

The class consists of all purchasers of Ampex's securities over a 27-month period for the prosecution of Section 10(b) claims based, with regard to each purchaser, on distinct alleged misrepresentations in connection with his respective purchase. As shown below specifically with regard to each of these points, the Judgment undermines the holding of this Court in *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975), which it does not consider, that a Section 10(b) claim must be based upon a misrepresentation *in connection with* the claimant's purchase or sale,* and vitiates the policy of this Court, set forth in that case,** to prevent judicial erosion of that rule because of the special potential for abuse of Section 10(b) claims, which as this Court said in *Blue Chip Stamps* present "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." 421 U.S. at p. 739. In addition, the Judgment violates Section 10(b) itself.

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*See 421 U.S. at p. 737.

**See 421 U.S. at pp. 738-749.

A. NEW JUDICIAL RULES FACILITATING PLAINTIFFS' PROOFS OF LIABILITY AND LIMITING PROOF OF DEFENSE

Having determined that there are common questions on the grounds that "whether a defendant's course of conduct is in its broad outlines actionable" is a common question of fact (Opinion at p. A-27) and "the accounting and legal principles requiring adequate reserves" constitute a common question of law (Opinion at p. A-31),* the Ninth Circuit concluded that such common questions are predominating, as against the overwhelming diversity in questions of law and fact in the proof of liability for such diverse misrepresentations, by ruling that (1) "plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all" (Opinion at p. A-36, f/n. 22), shifting to defendants the burden of disproving materiality as to individuals as a matter of defense, *and* (2) the test of the extent of defendants' right to disprove plaintiffs' *prima facie* case is the manageability of the action, stating that if defendants' attempted proof of their defense should render the case unmanageable, ". . . we may have to reconsider whether to make proof of causation from materiality conclusive . . ." (Opinion at p. A-36, f/n. 22).

The effect of these new rules is to create a vast expansion of the scope of Section 10(b) liability through class actions embracing undifferentiated Section 10(b) claims in which plaintiffs are permitted to establish a *prima facie,* and perhaps even a conclusive, case of causation through materiality generally provable in one trial from all evidence as to all alleged misrepresentations. This conclusion not only establishes the questionable substitution of materiality as *prima facie* proof of causation in place of reliance, but, far worse, implicitly substitutes a generalized materiality for the whole class in place of the materiality of a particular misrepresentation on which a particular purchaser's claim must be based.

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*This subject is discussed further below at p. 10.

At the same time, the new rules also make it practically impossible for defendants to address a defense to the misrepresentations, first, because the criss-crossing relationships in a single trial of evidence with regard to a particular misrepresentation bearing on the proof of another misrepresentation inevitably means that defendants would have to defend each claimed misrepresentation by rebuttal of evidence adduced in support of all misrepresentations; and second, because the rules, while vastly expanding defendants' burden of proof in defense, severely curtail what defendants may do to adduce their defensive proof by the new restrictions judicially imposed upon defendants to avoid unmanageability of plaintiffs' class.

The Judgment contravenes the policy of *Blue Chip Stamps* against the fashioning of unique rules of corroboration and damages correlative to the expansion of the scope of Section 10(b) because it adopts new substantive rules for facilitating plaintiffs' proof of Section 10(b) liability while restricting defendants' defense. It also violates Section 10(b) because that provision was not intended to enable claimants to prove their claims on the strength of misrepresentations not in connection with their respective purchases.

B. NEW RULES ON THE MEASURE OF DAMAGES

In its treatment of conflicts among the alleged class members (i.e., inadequacy of representation and untypicality of the class members' claims), the Ninth Circuit further contravenes the policy of *Blue Chip Stamps* by suggesting alternative theories of damages to eliminate conflict problems. Defendants argue that there are conflicts in the alleged class, *inter alia,* between class members who sold during the period (a substantial number, estimated at one-third of the class) and those who subsequently bought, because of the different interests between them concerning the time of a misrepresentation, if any, and whether it persisted at the point of sale (thus having no effect on selling price) or was

partly or fully disclosed (thus not being the basis of a claim for the later purchaser). The Ninth Circuit suggests that this obvious problem might be circumvented if, in place of the ordinary standard of out-of-pocket loss for Section 10(b) claims, the district judge might apply a rescissory measure of damages (Opinion at p. A-40). This is abandoning the out-of-pocket rule of damages as approved by this Court in *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 155 (1972), and potentially increasing them enormously, to cram conflicting claims into the apparent shape of a class, contrary to the policy of the *Blue Chip Stamps* case, to avoid the fashioning of unique rules of damages to extend Section 10(b) liability.

C. FUSION OF SEPARATE AND DISTINCT CLAIMS INTO ONE MASS CLAIM

The Ninth Circuit's Opinion makes it plain in its treatment of common questions that it is sanctioning mass prosecution of practically unlimited aggregations of Section 10(b) claims on a class basis against a particular company, its directors and its auditors. Where, as here, a class can be certified upon the generalizations that "whether a defendant's course of conduct is in its broad outlines actionable" is a common question of fact (Opinion at p. A-27) and "the accounting and legal principles requiring adequate reserves" constitute a common question of law (Opinion at p. A-31), the certification of the class means in effect that the rule of the *Blue Chip Stamps* case does not apply in class actions, which is the most common and important form of Section 10(b) cases. Under these tests or similar generalized allegations, all Section 10(b) cases could easily qualify as class actions. Indeed, the Ninth Circuit says that ". . . even when *unrelated* misrepresentations are alleged as part of a common scheme, class members may share common factual questions, and trial in the same forum avoids duplicative proof." (Opinion at p. A-29, f/n. 19) [emphasis added].

To permit securities purchasers to prosecute as class claims in one trial such different misrepresentations in connection with their respective purchases violates the holding in the *Blue Chip Stamps* case because it jumbles into an undifferentiated whole claims of certain class members based on their respective purchases, with other claims for other class members based on other misrepresentations in connection with other purchases, obliterating the fundamental nature of the claim by melding it with claims of others into a general class claim.

II. The Enabling Act Is Violated by Abridgement of the Substantive Rights of Defendants and Absent Class Members and by Enlargement of Substantive Rights of Plaintiffs to Facilitate Certification of a Class.

The Judgment of the Ninth Circuit violates the provision of the Enabling Act, 28 U.S.C. § 2072, that the Federal Rules of Civil Procedure shall not ". . . abridge, enlarge or modify any substantive right . . .," in three major respects in order to facilitate certification of a class under Rule 23, F.R.Civ.P.: (A) defendants' rights to prove their defense are abridged and modified by new rules of proof limiting defense against liability, and their exposure to damages may be greatly increased by enlarged new rules of damages, in order to facilitate determinations of predominance, manageability, typicality and adequacy of representation; (B) plaintiffs' substantive rights are enlarged correlatively and in other ways for class action purposes; and (C) the rights of absent class members to fair and adequate representation are abridged by the holding that the right to opt out can substitute for adequate representation and that there is adequate representation where there are numerous representatives ". . . who thus will probably represent whatever conflicting interests there are . . ." (Opinion at p. A-44).

A. DEFENDANTS' RIGHTS TO PROVE THEIR DEFENSES AGAINST LIABILITY ARE ABRIDGED AND MODIFIED BY NEW RULES OF PROOF, AND THEIR EXPOSURE TO DAMAGES MAY BE GREATLY INCREASED BY ENLARGED NEW RULES OF DAMAGES WHICH FURTHER FACILITATE PROOF OF LIABILITY

The Ninth Circuit's Opinion, in order to facilitate class certification under Rule 23(b)(3), F.R.Civ.P., reached the following conclusions: common questions predominate over individual questions of reliance because materiality of a misrepresentation establishes a prima facie case of causation; materiality may be proven in one mass trial because "plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all" (Opinion at p. A-36, f/n. 22); defendants' rights to disprove causation so proved by plaintiffs' prima facie case will be limited so as not to render the action unmanageable, failing which, proof of causation from materiality may be made conclusive (Opinion at pp. A-33 to A-39, especially f/n. 22); and the measure of damages may be broadened to resolve conflicts within the class. (Opinion at pp. A-39 to A-41).

These conclusions abridge and modify defendants' rights to prove their defense against liability in the following ways:

(1) The Class Action Requirements of Manageability and Predominance Must Govern the Extent of Defendants' Proof

Confronted with the problem that defendants' rights to disprove plaintiffs' prima facie case of causation through materiality might render the action unmanageable or render the common questions as found by the Court not to be predominant, the Ninth Circuit, contrary to the Enabling Act, has enthroned the requirements of manageability and predominance under Rule 23(b)(3) as the measure of defendants' substantive rights to make their proof. The Court says:

> "We think procedures can be found and used which will provide fairness to the defendants and a genuine resolution of disputed issues while obviating the danger of subverting the class action with delaying and harassing tactics. *If not, we may have to reconsider whether to make proof of causation from materiality conclusive,* keeping in mind that the Court has directed that the statute be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an overinclusive recovery to a defrauded class if the unavailability of the class device renders the alternative a grossly underinclusive recovery." (Opinion at p. A-36, f/n. 2) (emphasis added).

The Court states further:

> "Indeed, we could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation (*i.e.*, economic damage) regardless of transactional causation, without implicating the Enabling Act limitation." (Opinion at p. A-39, f/n. 24).

Such a conclusion is a far cry from the policy of this Court set forth in the *Blue Chip Stamps* case, not to further extend liability under Section 10(b) (see above at p. 7) beyond the present private compensatory mold. It is hard to imagine a more substantive change in defendants' rights than a change in the nature of proof of their liability. Furthermore, despite the statement of the Court that it could extend the nature of the liability under Section 10(b) without implicating the Enabling Act limitation (Opinion at p. A-39), the Opinion makes it clear that it threatens to do so for the purposes of promoting manageability and predominance under Rule 23(b)(3), and the actual present limitation on defendants' proof is explicitly based on manageability.

(2) The Measure of Damages May Be Fashioned to Eliminate Conflicts Otherwise Creating Inadequacy of Representation or Untypicality of Claims

The Ninth Circuit also suggests a departure from the standard out-of-pocket measure of damages in 10b-5 cases to an enlarged rescissory or consequential measure of the damages in order to

meet the problem of eliminating conflicts between members of the alleged class creating inadequacy of representation and untypicality of claims (Opinion at pp. A-39 ff.). This problem is inevitable between purchasers in the class who sold and later purchasers, the purchasers who sold necessarily having to demonstrate correction affecting their sale price in order to prove out-of-pocket damages caused by the misrepresentation, while later purchasers have to prove continued inflation from the same misrepresentation affecting their purchase price. Purchasers who sold and later purchasers would thus be in direct conflict with regard not only to quantum of damages, but necessarily with regard to issues of liability concerning the existence, effect and extent of misrepresentations at particular times giving rise to their respective damages.

The Ninth Circuit suggests new, enlarged measures of damages to try to avoid these obvious conflicts, positing the possibility of rescissory or consequential damages to avoid the conflicts. However, the measure of damages is a substantive rule of law. That measure in Section 10(b) cases has been "out-of-pocket" loss, i.e., the difference between what a purchaser paid and the real value as measured at the time of purchase. The enlargement of the measure of damages to rescissory or consequential damages alters the substantive rights of the parties in order to facilitate certification of the class.

Moreover, the Ninth Circuit concludes that such conflicts (and others) concern damages and are peripheral. (Opinion at p. A-41). However, the conflicts, unless the substantive rule of damages is changed, go to the very heart of the claims because the ordinary rule of out-of-pocket damages applied to the circumstances of this case inevitably creates conflicts as to substantive questions of liability on which damages must be based, i.e., whether and when there was a misrepresentation and whether, when and to what extent it was corrected. These problems are not peripheral, but dramatize the unsoundness of the generalized conclusion that there is any real common question.

(3) Liability Under Section 10(b) May Be Established as to Each of Various Diverse Alleged Misrepresentations in One Mass Trial of Materiality of All Alleged Misrepresentations

The right of defendants to separate trial of different claims against them, as well as to severance of claims in pre-trial proceedings where consolidation would create prejudice or be fundamentally unfair continues to be recognized under a long line of decisions, going back to *Johnson v. Manhattan Ry. Co.*, 289 U.S. 479, 496 (1933), where the Court said:

> "Under the statute, 28 U.S.C. § 734, consolidation is permitted as a matter of convenience and economy in administration, but does not merge the suits into a single cause, or change the rights of the parties, or make those who are parties in one suit parties in another."

See Garber v. Randell, 477 F.2d 711, 717 (2d Cir. 1973).

Nevertheless, the Ninth Circuit has ordained one mass trial of the materiality of all the alleged misrepresentations, of which some are relied upon by some members of the class, and others by other members, even with regard to unrelated misrepresentations, because "plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all." (Opinion at p. A-36, f/n. 22; p. A-29, f/n. 19; p. A-40, f/n. 25; and p. A-41). This is contrary to the decision in the *Blue Chip Stamps* case that a Section 10(b) claim may be based only upon a misrepresentation in connection with the purchase (or sale) by the claimant and prejudices substantial rights of defendants for the sake of certifying the class.*

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*Moreover, the eight class actions below were consolidated and lead counsel appointed for pre-trial purposes only at an early stage in the proceedings. The District Court did not decide on consolidated trial, and certified the class conditionally and "subject to adjustments by further order," thus, at least implicitly, leaving open the question whether one consolidated trial of all claims in the eight class actions would be appropriate. This is a matter which in the first instance should be in the trial court's discretion. Rule 42(a), Federal Rules of Civil Procedure; *In re Dearborn Marine Service, Inc.*, 499 F.2d 263, 270-71 (5th Cir. 1974).

(4) Materiality Proves Causation

The Ninth Circuit's Judgment also establishes the materiality of a misrepresentation as prima facie proof of causation (Opinion at pp. A-34 ff.), leaving defendants only a limited and perhaps short-lived opportunity to disprove materiality. In *Affiliated Ute Citizens v. United States,* 406 U.S. 128 (1972), this Court held:

> *"Under the circumstances of this case, involving primarily a failure to disclose,* positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. [Citations] This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. [Citation]" (At pp. 153-54) [emphasis added].

The circumstances included a relatively small group (85) to whom defendants owed an affirmative duty of disclosure which they failed to perform in essentially a privity situation involving special fiduciary relations.

The Ninth Circuit has translated that decision into a complete elimination of the requirement of reliance by Section 10(b) claimants for open market purchases. At most, *Affiliated Ute* means that there may be some circumstances in which proof of actual reliance is not required, as in pure non-disclosure cases, but it does not sanction the wholesale jettisoning of the requirement of reliance as a proof of causation, especially in large open market securities cases. The reasons are that securities purchasers buy securities for a wide variety of reasons, price is affected by a wide variety of factors other than a company's reports, and the materiality of a misrepresentation is at most one factor in the causation of a purchase at a particular price.

Moreover, the Ninth Circuit's position that reliance is not necessary in a misrepresentation case is in conflict with other substantial authorities. See, e.g., Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380-381 (2d Cir. 1974) *cert. denied,* 421 U.S. 976 (1975).

B. PLAINTIFFS' SUBSTANTIVE RIGHTS ARE ENLARGED BY NEW RULES FACILITATING PROOF OF LIABILITY AND DAMAGES

Plaintiffs' substantive rights are enlarged by the Ninth Circuit's Judgment, not only correlatively to the abridgement of defendants' rights with respect to proof of liability and measure of damages, but significantly in other ways as well. The Judgment establishes plaintiffs' right to prove liability by a *prima facie* case of causation on proof of materiality, to prove materiality of any particular alleged misrepresentation from expanded evidence of the materiality of other alleged misrepresentations, and from general "course of conduct," and to enjoy a drastically limited opposition to such relaxed proof of plaintiffs' claims, by restrictions on defendants' proof to conform to requirements of manageability.

The Judgment also suggests plaintiffs' right to possible rescissory and consequential damages in place of out-of-pocket damages, vastly expanding the ultimate potential recovery. The enlargement of damages from out-of-pocket to rescissory or consequential damages produces a further significant relaxation of requirements of proof of liability by large segments of the class, those who sold their securities during the class period, because it relieves them of any need to prove the effect on their sale price of alleged misrepresentations, as they would have to do under the rule of out-of-pocket damages. It also correspondingly reduces the requirements of proof by later purchasers who bought after earlier purchasers sold because they can base claims on misrepresentations also relied on by such earlier purchasers without diminution of their claims by reason of recovery by earlier purchasers who sold.

In short, under the new rules enunciated by the Ninth Circuit, plaintiffs in a class alleging Section 10(b) claims can not only prove their case collectively one for all and all for one, on the basis of just the materiality of misrepresentations, but they are also relieved of most of the proof of effect on market price of the misrepresentations determined to be material.

C. THE RIGHTS OF ABSENT CLASS MEMBERS TO FAIR AND ADEQUATE REPRESENTATION ARE ABRIDGED BY HOLDINGS THAT THE RIGHT TO OPT OUT CAN SUBSTITUTE FOR ADEQUATE REPRESENTATION AND THAT THERE IS PROBABLE ADEQUATE REPRESENTATION OF CONFLICTING INTERESTS BY COMPOSITE REPRESENTATION OF DIFFERENT GROUPS WITHIN THE CLASS BY THE SAME COUNSEL

(1) Right to Opt Out Is No Substitute for Adequate Representation

Absent class members cannot be bound by a determination in a class action in which they are not adequately represented simply because they have the opportunity under Rule 23 to opt out, as the Ninth Circuit states in its Opinion. (Opinion at p. A-43). Its holding on this point is unsound under the Rule (23(c)(2)) because the notice and opt-out provisions are *predicated* upon the existence of a class and are not a substitute for conforming with its requirements. The Ninth Circuit, in order to justify the certification of a class, has transformed the opt-out provision, applicable only where there is a class based on adequate representation, into a substitute for adequate representation. This conclusion is contrary to the holding of the Fifth Circuit in *Gonzales v. Cassidy,* 474 F.2d 67, 74, 76 (5th Cir. 1973).

(2) "Probable" Representation by a Collection of Plaintiff Representatives With the Same Counsel Is Not Fair and Adequate Representation

At the end of its Opinion, the Ninth Circuit says:

> "Finally, and unlike numerous cases in which even one representative has been held adequate to represent a prolonged class, the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus will probably represent whatever conflicting interests there are in the development of plaintiffs' trial strategies." (Opinion at p. A-44).

As pointed out in the Blackie petition for rehearing (f/n. at p. 10), there was no determination that there is fair and adequate

representation for several of the crucial periods following the issuance of the nine documents which plaintiffs state are the heart of their case. In fact, there is actually no representation, even in the form of plaintiff representatives, for members of the class in several of those periods, and other plaintiff representatives and intervenors who purchased in different crucial periods are represented by the same counsel, Messrs. Berger and Barrack.*

III. Due Process Is Violated by the Ninth Circuit's Present Limitation of the Scope and Timing of Defendants' Defenses Under Threat of Unconstitutional Irrebuttable Presumption of Causation and by Authorization of Proceedings to Bind Absent Class Members Without Fair or Adequate Representation, or Any Representation At All.

Two of the above-described changes in the parties' substantive rights are so fundamental that they violate the due process clause of the Fifth Amendment: (A) the limitation on defendants' rights to present defenses against Section 10(b) liability so as not to render plaintiffs' action unmanageable, under threat of unconstitutional irrebuttable presumption of causation from proof of materiality, and (B) the certification of a class action on behalf of absent class members not fairly or adequately represented and not represented at all, on the grounds that they can opt out on receiving notice or are "probably" represented by the presumed presence of representative plaintiffs, who nevertheless have the same counsel.

A. LIMITATION OF DEFENSES

"Due process requires that there be an opportunity to present every available defense." *Lindsey v. Normet,* 405 U.S. 56, 66 (1972); *American Surety Co. v. Baldwin,* 287 U.S. 156, 168 (1932). "It is an opportunity which must be granted at a meaningful time and in a meaningful manner." *Armstrong v. Manzo,*

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*See p. 24 below.

380 U.S. 545, 552 (1965); *Grannis v. Ordean,* 234 U.S. 385, 394 (1914).

The Ninth Circuit's Judgment, constituting the law of the case in this matter, and the law of the Ninth Circuit, plainly imposes on defendants the present obligation to limit their defenses to Section 10(b) liability to keep the litigation manageable as a class or to forego entirely the right to present a defense to the Court's rule of prima facie proof of causation from materiality (Opinion at p. A-36, f/n. 22). Although the Court mentions unexceptionable limitations against repetitive evidence and other reasonable limitations upon the defense against delaying and harassing tactics, the *test* set forth for the limits on presentation of the defense is *manageability* of the action. Furthermore, this restricted opportunity for presenting a defense may be postponed to the damage stage of the trial (Opinion at p. A-36, f/n. 22).

Both the present limitations imposed by this rule, even apart from the chill on the defense imposed by the threat of an irrebuttable presumption, and the threatened rule itself, are unconstitutional denials of due process.

(1) Present Restrictions on Proof in Defense to Maintain Manageability

The Ninth Circuit's Judgment not only eliminates the requirement that plaintiffs prove reliance, substituting materiality for reliance as proof of causation, but further limits defendants' proof against materiality, as well as reliance, to keep plaintiffs' action manageable. Defendants' ability to disprove materiality, as well as to prove that a particular plaintiff's purchase was in fact caused by factors other than defendants' alleged wrongdoing, would be governed by the requirements of manageability of the action plaintiffs chose to commence.

Furthermore, the postponement until the damage stage of the trial of the rebuttal of individual causation totally deprives defendants of any meaningful defense to liability by postponing the defense to liability until after liability has been established.

The Ninth Circuit's rule is arbitrary and unreasonable because:

(1) in practical operation, it means that defendants must weigh the presentation of their defense to liability against the effects of doing so on the manageability of the action;

(2) it facilitates maintenance of plaintiffs' case as a class action under Rule 23, which should be plaintiffs' responsibility alone, at the expense of defendants' right to defend against liability; and

(3) defendants' defense to liability may be postponed until after liability has been established.

(2) The Threat of an Unconstitutional Irrebuttable Presumption

In *Vlandis v. Kline,* 412 U.S. 441 (1973), this Court held a statutory irrebuttable presumption to be contrary to the due process clause of the Fourteenth Amendment to the Constitution, citing other cases under both the Fifth and Fourteenth Amendments invalidating presumptions which are arbitrary and unreasonable and operate to deny a fair opportunity to rebut them. *Vlandis v. Kline,* 412 U.S. at 446 (1973); *Manley v. Georgia,* 279 U.S. 1, 6 (1929).

The Ninth Circuit's present limitation on defendants' proof and the threatened irrebuttable presumption are arbitrary and unreasonable because:

(1) they impose the threatened sanction of a change in the rule of law to make the presumption irrebuttable if defendants proceed far enough with their defense to render plaintiffs' class unmanageable;

(2) they threaten to create an irrebuttable presumption not necessarily or universally true in fact because the materiality of a misrepresentation does not necessarily mean the causation of the purchase made in connection with it, as the Ninth Circuit itself recognizes earlier in its Opinion by attempting to categorize the means by which defendants

might rebut the presumption, so long as it has not been made irrebuttable (Opinion at p. A-35);

(3) reasonable alternative means exist for the determination of the proof of liability by separation of the multitude of claims made into distinct classes conforming to the requirements of Rule 23, which would greatly reduce the problems of manageability of the claims made in a single class action.

B. SANCTIONING A CLASS ACTION IN WHICH ABSENT CLASS MEMBERS ARE NOT ADEQUATELY REPRESENTED OR NOT REPRESENTED AT ALL

In *Hansberry v. Lee,* 311 U.S. 32 (1940), and more recently in *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 176 (1974), the Supreme Court confirmed the importance of adequacy of representation for due process in class action cases. The Ninth Circuit's Judgment permits the certification of a class even when there are conflicts among class members, on the grounds that (1) ". . . under the notice and opt-out procedure of Rule 23(b)(3) and 23(c)(2), an absent class member may evaluate his position in the class and decide for himself whether to avail himself of the representation offered" (Opinion at p. A-43), and (2) ". . . the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus will probably represent whatever conflicting interests there are in the development of plaintiffs' trial strategies" (Opinion at p. A-44).

(1) Opt-Out Is No Substitute for Fair and Adequate Representation

However, the position of the Ninth Circuit is constitutionally unsound. Under *Hansberry,* class members may have different positions, but there may not be *conflicts* among class members. Characterizing the conflicts as only "secondary" or "peripheral," as the Ninth Circuit has done, does not satisfy due process requirements because the courts should not prejudge the effects of constitutional violations of the rights of absent parties without

adequate representation. This was so held by the Fifth Circuit in *Gonzales v. Cassidy,* 474 F.2d 67 (5th Cir. 1973):

> "Due process of law would be violated for the judgment in a class suit to be res judicata to the absent members of a class unless the court applying res judicata can conclude that the class was adequately represented in the first suit. [Citations]" (at p. 74.)
>
> "The purpose of Rule 23 would be subverted by requiring a class member who learns of a pending suit involving a class of which he is a part to monitor that litigation to make certain that his interests are being protected; this is not his responsibility—it is the responsibility of the class representative to protect the interests of all class members." (at p. 76.)

(2) Class Members With Divergent Interests in the Admitted Nine Different Crucial Alleged Misrepresentations Are Not Represented by Plaintiff Representatives or by Separate Counsel

Without any determination having been made, the Ninth Circuit asserts that:

> "[U]nlike numerous cases in which even one representative has been held adequate to represent a prolonged class, the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus *will probably represent* whatever conflicting interests there are in the development of plaintiffs' trial strategies." (Opinion at p. A-44) [emphasis added].

This hope of "probable representation" is not sufficient to satisfy the requirements of due process because there is no determination that there is at least one class representative who purchased in connection with each of the nine documents (the two annual and seven quarterly reports) admitted by plaintiffs to be the crucial misrepresentations. Moreover, the alleged class lacks not only a named plaintiff representative for each such misrepresentation, but also lacks separate counsel for each of the divergent interests asserted, inasmuch as most of the named

plaintiffs are represented by the same counsel, Messrs. Berger and Barrack.*

As shown by the chart of the respective purchases made by the named class representatives and intervenors, which was furnished to the Court of Appeals** and to the District Court*** no purchase was made by any named class representative or intervenor from the beginning of the class period May 2, 1970, to August 13, 1970; nor from August 21, 1970 to March 5, 1971; nor from January 13, 1972 to the end of the class period, August 3, 1972. Thus, during approximately 15 of the 27 months of the class, no named representative or intervenor even made a purchase of Ampex stock. As a result any absent class member whose purchase occurred during one of these periods has no named representative to represent his particular time period and no counsel who would be in a position to represent his particular interests.

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*Messrs. Berger and Barrack represent class representative Sylvia Barrack (now Leonard Barrack, et al. as Executors of her Estate) and intervenors Dooling, McDevitt, Sigafoos, the Abrahams and the Kogoks.

**Exhibit 6 to the Brief on Appeal of defendant-appellant Touche Ross & Co.

***Exhibits F and G to Appendix I to Memorandum of Defendants Blackie, et al. In Opposition to Plaintiffs' Motion for Class Action Determination, which Memorandum was also appended to the Petition to the Ninth Circuit for Permission to Appeal.

CONCLUSION

For the reasons set forth above, petitioners respectfully pray that this Court grant a writ of certiorari to review the Judgment of the United States Court of Appeals for the Ninth Circuit.

Dated: March 4, 1976

Respectfuly submitted,

ARTHUR R. ALBRECHT
ROBERT C. BARRETT

Attorneys for Petitioners William Blackie, Robert E. Brooker, Richard J. Elkus, Arthur H. Hausman, Henry A. McMicking, Nathan W. Pearson, A. E. Ponting, Frederick Seitz, and Irving Trust Company, as Executor of the Estate of H. S. M. Burns, Deceased

THEODORE P. LAMBROS

Attorney for Petitioner Ampex Corporation

APPENDIX

MEMORANDUM OPINION AND ORDER OF THE DISTRICT COURT

Original Filed Apr 11 1974
Clerk, U.S. Dist. Court
San Francisco

In the United States District Court
for the Northern District of California

Master File No. C-72-360 SW

In Re Consolidated Pretrial)
Proceedings in Ampex Securities Cases)

This document relates to:
Molder (formerly BARRACK)
File No. C-72-521 SW

MEMORANDUM OPINION AND ORDER

This action is brought by Mrs. Barrack, through her executors, Leonard Barrack, Pearl Singer Molder and Selma Molder, on behalf of herself (now her estate) and all other purchasers of Ampex securities between May 2, 1970 and August 3, 1972. The complaint charges violations of sections 10(b) and 13(a) of the 1934 Securities and Exchange Act, 15 U.S.C. § 78j(b) and § 78n(a) and the Rules 10b-5 and 13 promulgated thereunder, 15 C.F.R. 240.10b-5 and 240.13.[1] Jurisdiction is premised on 15 U.S.C. § 78aa.

This action is before the Court on plaintiffs' motion to certify a class. It is this motion to which the Court will address itself.

After careful consideration of the volumes of papers submitted, the arguments and authorities on both novel and well worn

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1. The amended Molder complaint also contains a count of breach of fiduciary duty against defendant Roberts brought derivatively under alternative theories of 10b-5 violations and common law. This count has been previously dismissed on defendant Robert's [sic] 12(b)(6) motion. Thus the Court will not address any objections to certification based upon this count.

theories, the Court finds that a conditional class defined as all Ampex security purchasers within the designated 27-month period is warranted. Rule 23(c)(1). The Court, however, on a proper factual showing, reserves the right to reduce or expand the class as to time, types of securities, or types of transactions, to designate appropriate subclasses and to terminate the class. Rule 23(c)(4).

FACTS

Although this is extremely complicated litigation not easily summarized, the crux of the allegations is that Ampex and its officers, directors and auditors (Touche Ross) conspired and aided and abetted in misrepresenting, in various publications, the corporation's earnings and financial condition. These publications include, but are not limited to annual reports, interim reports, press releases, and SEC filings.[2] The period of time, over which these violations allegedly occurred and coinciding with the period of this class, commenced May 2, 1970 when the 1970 annual report issued,[3] and terminated August 3, 1972 when Touche Ross withdrew its certificate.[4]

More specifically plaintiffs claim that defendants misrepresented the corporation's financial security by the deceitful use of certain accounting procedures. It is claimed that the corporation's reports did not reveal specific crucial items, e.g., the true depreciated value

2. During the 27-month period in question there are claimed to have been 3 annual reports, six quarterly interim reports, 469 press releases and 119 filings with the SEC. Although not definitively narrowed, it seems that the alleged violations involve some 45 of these publications.

3. There appears to be a factual dispute concerning the date of the 1970 annual report. The plaintiffs claim the class begins with the issuance of this document May 2, 1970 but some defendants claim that it did not issue until July 1970.

4. In this 27-month period there were 570 business days during which there were 120,000 transactions in Ampex securities with a total of 21,000,000 shares traded.

of inventories, deferred research and development expenses, accurate asset to liability ratios, contingent liabilities not covered by adequate reserves, and the accurate value of discontinued items. The cumulative effect, according to plaintiffs, was to give the investment community the impression that Ampex was more secure than was perhaps warranted, thus causing its stock to sell at artificially inflated prices. In mid-1972 Ampex reported an approximate $90,000,000 loss.

Plaintiffs further allege that throughout this 27-month period between the initiation of these deceptive practices and the precipitous fall, Ampex took steps to partially correct certain "accounting errors."[5] These corrections allegedly caused downward adjustments in the value of Ampex securities, but these corrections also allegedly had the effect of lulling investors into believing the corporation's financial position was finally stable when, in reality, more distressing financial news was forthcoming.

The class that plaintiffs seek to represent encompasses all purchasers of Ampex securities within the 27-month period. At this point no one really knows how many members this class would include, although the defendants estimate that it could include upwards of 100,000 investors.[6] The class purportedly include both past and present shareholders and debenture holders.

Based upon these statistics, all parties agree that the asserted class is so numerous that joinder is impracticable, Rule 23(a)(1),

5. Some examples of these partial disclosures are as follows: the announcement March 16, 1971 that the company had not been expensing research and development currently, resulting in a 10.7 million dollar loss; the announcement January 11, 1972 of a 40 million dollar loss due to lack of reserves to cover contingent liabilities, doubtful accounts, and discontinued lines; the announcement shortly after January 1972 that 40 million was a low estimate of the loss; and the announcement in the 1972 annual report (March, 1972) of an 86 million dollar loss for the whole year.

6. Of these investors it is estimated that perhaps 35,000 also resold during the period and 46,000 no longer hold Ampex securities.

but there is no agreement on the other requirements of Rule 23.[7]

Defendants have raised many potential problems which could affect the viability of this proposed class. Fulfillment of all Rule 23 requirements aside from 23(a)(1), numerosity, has been challenged on several theories. After tedious culling, the Court is of the opinion that the arguments concerning manageability, superiority and adequacy of representation by plaintiffs' attorneys to the extent not handled *infra* lack merit. No doubt management of this class will not be simple, but the Court does not envision the necessity of thousands of days of trial with hundreds of interlocking subclasses before several juries, as feared by defendants.

Any conflicts that Mrs. Barrack's executors as class representatives may have with their role as executors does not affect their ability to represent the members of this class. Whether their role herein would pose a justiciable issue for the estate or beneficiaries thereof would necessarily have to be raised and litigated elsewhere. It does not conceivably create representation problems here.

Other issues raised concerning the competency of plaintiff's counsel to represent this class are unconvincing and not worthy of discussion.

Accordingly, in passing on plaintiffs' motion the Court will only focus on the questions of commonality of fact or law and a number of the alleged conflict of interest problems.

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7. The § 13(a) claim in Count II cannot proceed as a class action and must be pursued individually by the named plaintiffs. Defendants allege and the Court agrees that private actions for 13(a) violations can only proceed under the authority of § 18(a), 15 U.S.C. § 78r(a). *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1340 (E.D. Pa. 1972). Section 18(a) requires by its very language individual, subjective reliance by those seeking relief thereunder. See, *Heit v. Weitzen,* 402 F.2d 909, 916 (2d Cir. 1968). Requiring proof of individual reliance for each class member would necessarily defeat commonness of issues of law or fact and preclude a class action on that count. This does not, of course, preclude the certification of the class for the purposes of the 10b-5 count. Rule 23(c)(4)(A).

COMMON ISSUES OF LAW AND FACT AND PREDOMINANCE OF COMMON QUESTIONS

Defendants argue that there is no commonality on the issues in this action because the only commonness pleaded is conspiracy; that is plaintiffs seek to tie a series of individual wrongs together with a veil of conspiracy. That allegations of conspiracy alone cannot create common issues of fact and law is not disputed. See *Richland v. Cheatham,* 272 F.Supp. 148 (S.D.N.Y. 19[illegible]). Although confusingly pleaded, the Court is convinced from the total record that conspiracy is not the lynch pin which holds this cause of action together. Conspiracy is only the device employed by plaintiffs to sweep in the numerous defendants.

The common issues of law and fact and the common issues which predominate are the various alleged misrepresentations and omissions originating in the May 2, 1970 annual report concerning overstated inventory, buried research and development costs and misstated current ration [sic] of assets to liabilities, among other things, creating an erroneous image of prosperity. These possible accounting failings which are alleged § 10(b) violations reappear again in the 1971 annual report along with other alleged misrepresentations. The incidents of fraud were then allegedly repeated and enhanced in the various other publications purported to be links in this chain of misrepresentations. This appears to the Court to be the classic situation of the "standing dominoes" discussed in *Fischer v. Kletz,* 41 F.R.D. 377, 381 (S.D.N.Y. 1966). If it is proved, for instance, that the value of the inventory was materially mispresented [sic] in the 1970 Annual Report, mere proof of the repetition of this overstatement would suffice to prove another violation. Since this would also be true for each of the alleged representations or omissions, the Court is of the opinion that the allegations constitute a "common course of conduct over the entire

period, directed against all investors. . . ," *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 914 (9th Cir. 1964), cited also in *Fischer v. Kletz, supra* at 381. See also the analysis of the Fischer rationale in *Richland v. Cheatham, supra* at 155.

This case is admittedly more complicated than *Fischer,* with many more potential representations and possible interim intervening curative representations which may or may not eliminate the causal effect of some of the alleged accounting misrepresentations. These complications, although troublesome to the proof of causation and damage, do not militate against this finding of commonness upon the record now before us.

Defendants also argue that actual subjective reliance must necessarily be required before recovery could be granted, especially in a non-privity case such as this,[8] and that in a class this size with many representations at many different times, the diverse issues of reliance alone preclude the existence of common issues of law and fact. Subjective reliance as these defendants urge is not now an element of proof necessary to prevail on this action, see *Affiliated Ute Citizens v. United States,* 406 U.S. 128 (1972); see also the discussion in *Grad v. Memorex Corp.,* 61 F.R.D. 88, 97-101 (N.D. Cal. 1973), and thus does not destroy the question of commonness here. The more reasonable reliance theory commonly applied in these large security cases is causal connection or causal nexus. Although proof of the causal nexus between the alleged fraud and the inflated price and the harm incurred will undoubtedly be complex, it neither precludes commonness nor typicality. At this point, the Court also cannot say that it would make this class inherently unmanageable

8. The defendants argue forcefully that lack of privity distinguishes this case from those cases which hold that neither subjective reliance nor scientor are required to prevail in 10b-5 suits. They further argue that these elements must be proved and that the application of Rule 23 cannot change this substantive requirement. To the extent it is necessary to decide this issue on this motion the Court finds defendant's arguments unpersuasive. See the discussion in *Grad v. Memorex, Cited infra.*

CONFLICTS

First, Ampex argues that the application of the correct damage theory to these facts would create irreconcilable conflict among the members.[9] Assuming *arguendo,* that the appropriate damage formula is out-of-pockets as urged by defendants, and also that the intrinsic value of the stock is measured by the difference between the price immediately before and the price immediately after the partial corrections, the Court is still unpersuaded that irreconcilable conflicts between the members destroy commonality of issues or render the class unmanageable. After studying the number of examples presented in the papers, the Court is not convinced that the proofs required to prove one member's damage or the plaintiffs' damage operates against the next member's claim or precludes the plaintiff from asserting that member's rights with equal zeal. At this point, there is no reason to believe that the members' various positions are diametrically opposed to each other.

It is further argued that under any theory, assuming causation as pleaded, there is an inherent conflict when one member alleges that he sold at a loss while at the same time another member alleges he bought at a fraudulently induced inflated price. If there was only partial disclosure, it is not inconceivable that one member may be selling out at a loss at the same time one

9. Problems measuring damages are not usually considered in determining a class, *Herbst v. Able,* 47 F.R.D. 11, 17 (S.D.N.Y. 1969); *Grad v. Memorex, supra; Dorfman v. First Boston Corp.,* Civil Action No. 70-1845 (E.D. Pa. 1973), but when, as here, it is purported that the damage theory may affect the causal connection between the alleged fraud and the injury, defeating commonality and typicality the Court will consider it for that purpose only.

Ampex alleges that the plaintiff's damage theory, the difference between the purchase price and the sales price after partial disclosure, is tantamount to rescissory damages and thus inappropriate in a non-privity situation. They further argue that the correct measure would be out-of-pocket, that is the difference the purchase price and the true value at the time of the purchase [sic]. It is unnecessary to rule on this point at this time.

member buys in at a price still inflated due to yet undisclosed fraud. Admittedly these circumstances greatly complicate this case but they do not create obvious conflicts which are irreconcilable.

Neither does the Court find persuasive defendant's arguments that debenture purchasers and stock purchasers cannot be represented by a shareholder and are in such conflict with plaintiff as to preclude any commonality of the issues. Although it is not unimaginable that purchasers of debentures could be influenced by considerations other than those influencing stock investors, see *Carlisle v. LTV Electronics, Inc.,* 54 F.R.D. 237 (N.D. Tex. 1972), the Court, at this time is not convinced that these differences exist here.[10] The very nature of the positions of these two security holders does not as a matter of law preclude their inclusion in the same class. See *Fischer v. Kletz,* supra at 384; *In re Ceasars* [*sic*] *Palace Securities Litigation,* CCH Sec.L.R. § 94,005, 94,049.[11] The Court does concede that there may well have to be a distinct damage analysis employed to determine debenture holders' losses, but these are problems which can be solved with subclasses. They do not frustrate the certification of this class.

Defendants also urge that there is a conflict between those potential class members who purchased within the 27-month period and have since sold all their shares and those who still now hold their shares, because success of this lawsuit would

10. The Court has noted that in C-72-360 SW, *Kushner v. Ampex, et al,* consolidated with the subject case for pretrial proceedings, the complainant is a debenture purchaser and complains of exactly the same wrongdoing in the connection and sale of his security as does plaintiff Molder.

11. *Dolgow v. Anderson,* 43 F.R.D. 472, 492 (E.D.N.Y. 1968) and *Herbst v. Able,* 278 F.Supp. 669 (S.D.N.Y. 1967), relied on by the defendants, do not militate against this finding since they merely found under their particular circumstances and at the stage of their proceedings, these two groups should not proceed together while recognizing that this would not apply to all situations.

be to the latter's detriment. Again, if these conflicts do prove viable then appropriate subclasses may be the answer. See *Herbst v. Able,* 47 F.R.D. 11, 15 (S.D.N.Y. 1969).

Finally, defendant Touche Ross claims that if a class is certified it should not be allowed to proceed against them, since they were only involved with *Ampex* for nine of the 117 weeks in the class period. Even assuming the validity of this assertion, this would appear to be irrelevant to certifying the class. See *Fogel v. Wolfgang,* 47 F.R.D. 213 (S.D.N.Y. 1969). Procedural devices are available to Touche Ross to narrow the issues as to them. Also since this is, as of yet, a conditional class necessary adjustments and subclasses could solve this problem.

In accordance with the findings expressed herein, the Court ORDERS that the plaintiffs' motion to certify this class is HEREBY GRANTED subject to the following conditions:

1. the class shall be defined as all those purchasers of Ampex securities between May 2, 1970 and August 3, 1972;
2. the class is a conditional class subject to adjustments by further order of this Court;
3. the class action is limited to the 10b-5 cause of action stated in Count I of plaintiffs' complaint;
4. and plaintiffs shall bear the cost of notifying the class after Court approval of notice form and timing in accordance with *Eisen v. Carlisle & Jacqueline,* 479, F.2d 1005 (2d Cir. 1973).

Dated: April 10, 1974.

/s/ SPENCER WILLIAMS
UNITED STATES DISTRICT JUDGE

OPINION OF THE COURT OF APPEALS

William BLACKIE et al.,
Defendants-Appellants,
v.
Leonard BARRACK et al.,
Plaintiffs-Appellees.

AMPEX CORPORATION,
Defendant-Appellant,
v.
Benjamin L. KUSHNER,
Plaintiff-Appellee.

William E. ROBERTS and John Buchan, Defendants-Appellants,
v.
Benjamin L. KUSHNER et al.,
Plaintiffs-Appellees.

TOUCHE ROSS & CO.,
Defendant-Appellant,
v.
Leonard BARRACK et al.,
Plaintiffs-Appellees.

William E. ROBERTS et al.,
Defendants-Appellants,
v.
Leonard BARRACK et al.,
Plaintiffs-Appellees.

Nos. 74-2141, 74-2341, 74-2167, 74-2466 and 74-2648.
United States Court of Appeals, Ninth Circuit.
Sept. 25, 1975.

Arthur R. Albrecht (argued), McCutchen, Doyle, Brown & Enersen, San Francisco, Cal. for defendants-appellants in No. 74-2141.

David Berger (argued), Philadelphia, Pa., for plaintiffs-appellees in No. 74-2141.

Theodore P. Lambros (argued), San Francisco, Cal., for defendant-appellant in No. 74-2141.

Stephen V. Bomse (argued), Heller, Ehrman, White & McAuliffe, San Francisco, Cal., for defendants-appellants in No. 74-2341.

Thomas Elke (argued), San Francisco, Cal., for plaintiff-appellee in Nos. 74-2341 and 74-2648.

William W. Godward (argued), Cooley, Godward, Castro, Huddleson & Tatum, San Francisco, Cal., for defendant-appellant in No. 74-2466.

Melvyn I. Weiss (argued), Millberg & Weiss, New York City, for plaintiff-appellee in Nos. 74-2466 and 74-2648.

Thomas A. H. Hartwell (argued), Cooley, Godward, Castro, Huddleson & Tatum, San Francisco, Cal., for plaintiff-appellee in No. 74-2648.

OPINION

Before TUTTLE,* KOELSCH and BROWNING, Circuit Judges.

*The Honorable Elbert P. Tuttle, United States Court of Appeals Senior Circuit Judge for the Fifth Circuit, sitting by designation.

KOELSCH, Circuit Judge:

These are appeals from an order conditionally certifying a class in consolidated actions for violation of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240. 10(b)-5.

The litigation is a product of the financial troubles of Ampex Corporation. The annual report issued May 2, 1970, for fiscal

1970, reported a profit of $12 million. By January 1972, the company was predicting an estimated $40 million loss for fiscal 1972 (ending April 30, 1972). Two months later the company disclosed the loss would be much larger, in the $80 to $90 million range; finally, in the annual report for fiscal 1972, filed August 3, 1972, the company reported a loss of $90 million, and the company's independent auditors withdrew certification of the 1971 financial statements, and declined to certify those for 1972, because of doubts that the loss reported for 1972 was in fact suffered in that year.

Several suits were filed following the 1972 disclosures of Ampex's losses. They were consolidated for pre-trial purposes. The named plaintiffs in the various complaints involved in these appeals[1] purchased Ampex securities during the 27 month period between the release of the 1970 and 1972 annual reports, and seek to represent all purchasers of Ampex securities during the period. The corporation, its principal officers during the period,[2] and the company's independent auditor are named as defendants. The gravamen of all the claims is the misrepresentation by reason of annual and interim reports, press releases and SEC filings of the financial condition of Ampex from the date of the 1970 report until the true condition was disclosed by the announcement of losses in August of 1972.

The plaintiffs moved for class certification shortly after filing their complaints in 1972; after extensive briefing and argument the district judge entered an order on April 11, 1974, conditionally certifying as a class all those who purchased Ampex securities

1. The lead action here, the so-called *Molder* action, was originally filed in the Eastern District of Pennsylvania in January of 1972, and transferred to the Northern District of California, where it was consolidated for pretrial with seven other actions. Twelve parties have been allowed to intervene as plaintiffs in the *Molder* action.

2. Appellants Roberts and Buchan terminated their relationship with Ampex during the class period; the remaining individual defendants were in office throughout the period.

during the 27 month period. The defendants filed notices of appeal from the order of certification on May 9 and 10, 1974.[3]

Additionally, the district judge, in an order entered July 1, 1974, denying a motion made by defendants Roberts and Buchan, and defendants Blackie, *et al.*, for reconsideration of the class certification, permitted those defendants to seek an interlocutory appeal from that order under 28 U.S.C. § 1292(b).[4] We granted the petition for interlocutory review.[5] That appeal was designated No. 74-2648, and consolidated with the direct appeals.

In December of 1974, plaintiffs filed a motion to dismiss the various appeals—the purportedly direct appeals on the ground that the certification order is not appealable under 28 U.S.C. § 1291, and the § 1292(b) appeal on the ground that it has been prosecuted in a dilatory manner.

The appeals having now been heard and submitted, we face three issues: 1) whether the order certifying the class is a final order appealable under § 1291; 2) whether the interlocutory appeal should be dismissed; and (if any of the appeals are properly before us) 3) whether the district court order certifying the class was proper under the standards set out in Fed.R.Civ P.23(a) and (b)(3). To summarize our decision, we hold the certification order non-appealable and dismiss the direct appeals; we deny the motion to dismiss the § 1292(b) certified appeals;

3. The direct appeals are designated Nos. 74—2141, 74—2341, 74—2167, and 74—2466.

4. The district court did not grant permission to appellants Touche and Ampex to seek interlocutory review, as they had not joined in the motion for reconsideration filed before the filing of their notices of appeal. The court assumed that the filing of the notices divested him of jurisdiction over those defendants. We reject Ampex' argument that it is here under § 1292(b) by virtue of its codefendant's interlocutory appeal and its own filing of a notice of appeal under Fed.R.App.P. 4. The taking of an interlocutory appeal requires a discretionary judgment by both the district court and court of appeals—that judgment is exercised with respect to particular parties. As a result, Fed.R.App.P. 5 does not provide, as does Rule 4, for parties to join in others' appeals.

5. Thus, whether the standards for certification of such an appeal set out in § 1292(b) were met has been decided, and is not now before us.

and, on the merits, hold that the suit may properly be maintained as a class action.

I. Appealability under § 1291 of an order granting class action status.

The courts of appeals have jurisdiction over appeals of right under 28 U.S.C. § 1291 only from "final decisions" of the district courts. The statutory limitation is the product of a two-fold policy judgment about judicial administration which was written into the first Judiciary Act and adhered to ever since. *See Cobbledick v. United States,* 309 U.S. 323, 324-325, 60 S.Ct. 540, 84 L.Ed. 783 (1940). The requirement saves judicial time by eliminating review of rulings adverse to an eventually successful litigant. But more importantly, the uniform imposition of finality as a condition of review improves the quality of justice administered by the judicial system. On balance, the rule shortens the time needed for resolution of controversies, saving litigants both time and money; "[requiring finality avoids] the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment." *Cobbledick, supra* at 325, 60 S.Ct. at 541. In short, the rule is one of the primary bars against Bleak House Judicial administration;[6] as such, its rationale applies equally to an order certifying a class

6. A system of judicial administration, fortunately unknown in this country,

> "which has its ruined suitor, with his slipshod heels and threadbare dress, borrowing and begging through the round of every man's acquaintance; which gives to monied might, the means abundantly of wearying out the right; which so exhausts finances, patience, courage, hope; so overthrows the brain and breaks the heart; that there is not an honorable man among its practitioners who would not give—who does not often give—the warning, 'Suffer any wrong that can be done you, rather than come here!' "

Dickens, Bleak House, quoted in The World of Law—I, The Law *in* Literature 42 (E. London ed. 1960).

Nevertheless, in some circumstances deferring an appeal practically operates to deny effective review, as the right threatened by an adverse ruling will have been lost in the interim before final disposition of the other aspects of the controversy. The Court therefore has given the § 1291 final decision requirement a "practical rather than a technical construction," *Cohen v. Beneficial Industrial Loan Corp.,* 337 U.S. 541, 548, 69 S.Ct. 1221, 1226, 93 L.Ed. 1528 (1949), and allowed interlocutory appeal from a "small class [of orders] which finally determine claims of right separable from and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen,* at 546, 69 S.Ct. at 1225. *See Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 170-172, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974) (*Eisen IV*); Note, *Class Action Certification Orders: An Argument for the Defendant's Right to Appeal,* 42 Geo.Wash.L.Rev. 621, 625-628 (1974). Two of the three circuits which have faced the issue have nevertheless held a class certification order non-appealable under *Cohen. Thill Securities Corp. v. New York Stock Exchange,* 469 F.2d 14 (7th Cir. 1972); *Walsh v. City of Detroit,* 412 F.2d 226 (6th Cir. 1969). *Accord,* 9 J. Moore, Federal Practice ¶ 110.13[9], at 184-187 (2d ed. 1970).

The Second Circuit, however, has permitted appeal in certain limited circumstances. In *Eisen v. Carlisle & Jacquelin,* 370 F.2d 119 (2d Cir. 1966), *cert. denied,* 386 U.S. 1035, 87 S.Ct. 1487, 18 L.Ed.2d 598 (1967) *(Eisen I),* that court recognized that an order denying class action status effectively sounded the "death knell" of the plaintiff's suit. As "no lawyer of competence is going to undertake this complex and costly case to recover $70 for Mr. Eisen," the individual claim could not be adjudicated, and as a practical matter the class question could never be appealed. The court therefore concluded the order was appealable under *Cohen.* We have adopted the death knell doctrine. *Falk v. Dempsey-Tegeler & Co., Inc.,* 472 F.2d 142 (9th Cir.

1972); *Weingartner v. Union Oil Company of California,* 431 F.2d 26 (9th Cir. 1970).

From that springboard the Second Circuit developed a "reverse death knell" doctrine with respect to a defendant and his rights to foreclose an ostensible class suit against him. Influenced by the suggestion that it consider a rule which would "afford equality of treatment as between plaintiffs and defendants" (*Korn v. Franchard Corp.,* 443 F.2d 1301, 1307 (2d Cir. 1971) (Friendly, J., concurring)), a panel of the circuit held in *Eisen v. Carlisle & Jacquelin,* 479 F.2d 1005, 1007 n. 1 (2d Cir. 1973) *(Eisen III),* that defendants could appeal an order granting class status under three specified conditions. As explicated in *Herbst v. International Telephone and Telegraph Corp.,* 495 F.2d 1308, 1312 (2d Cir. 1974), such an order is appealable when the class determination is " 'fundamental to the further conduct of the case' " (*i.e.,* when, were the class determination reversed, the individual claims presented would be too small to continue the suit, thus effectively terminating it—the reverse death knell situation);[7] when the *order* is " 'separable from the merits;' " and when it will result in " 'irreparable harm to the defendant in terms of time and money spent in defending a huge class action.' " *Herbst,* at 1312, quoting from *Eisen III,* at 1007 n. 1. We are asked, the issue being novel in this circuit, to adopt the Second Circuit's position.[8]

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7. *See General Motors Corp. v. City of New York,* 501 F.2d 639, 645 (2d Cir. 1974); *Kohn v. Royall, Koegal and Wells,* 496 F.2d 1094, 1099 (2d Cir. 1974). *But see General Motors Corp., supra,* at 656-657.

8. Wholly aside from our disagreement with the Second Circuit rule, we doubt that the order involved here would be appealable under that rule. Including intervenors, the named plaintiffs purchased 10,000 shares during the class period and damages would appear to be such that the action would proceed were the order reversed. Thus, criteria 1 may not be satisfied. *See, e.g., Falk, supra* (holding individual claim of $14,125 too large to invoke death knell doctrine); *Shayne v. Madison Square Garden Corp.,* 491 F.2d 397 (2d Cir. 1974) (individual claim of $7,482 too large); *Milberg v. Western Pacific R. R.,* 443 F.2d 1301 (2d Cir. 1971) ($8,500 claim too large). Moreover, in this case the second criteria is probably not met either. *See Kohn, supra,* at 1099; *General Motors Corp., supra,* at 646, 659.

We decline to do so, because we believe that the Second Circuit's rule impermissibly[9] disregards the conditions placed on appealability by *Cohen.* The rule of finality is a statutorily imposed restraint on our jurisdiction; as noted, it imposes a legislative judgment that on balance time and money will be saved if appeal is deferred until the conclusion of a suit. We are not free to disregard that judgment; exceptions to uniform application undermine the rule's purpose by fostering litigation about whether an order is exceptional and appealable. And with the proliferation of narrow and peculiar exceptions, the more doubtful and difficult it becomes to determine appealability, at district and appellate court levels, increasingly inviting supposedly foreclosed interlocutory litigation.

In this view and while recognizing that it is nevertheless such an exception, we think the *Cohen* "collateral order" standards should be restrictively construed. The *Cohen* rule is an effort to prevent the inevitable injustices to litigants which result from application of a prophylactic rule which operates "on balance," but only in those limited situations where it can be accomplished with a minimum intrusion on the statutory policy. Thus, *Cohen* requires not only that denial of immediate review result in loss of a right which cannot be sustained by later review, but also that the order appealed from be final and collateral. Thus, even when an injustice may result, immediate review is available only when the appellate court will not be required to duplicate efforts entailed in a later review on the merits, or to review a decision whose tentative na-

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9. We recognize that it is not altogether certain that the *Cohen* standards represent the outer parameters of appealability, in light of the Court's admonition in that case to give the final decision rule a practical rather than technical construction, and its later observation in *Eisen IV,* 417 U.S. at 170, 94 S.Ct. at 2149, that "[n]o verbal formula yet devised can explain prior finality decisions with unerring accuracy or provide an utterly reliable guide for the future." However, we think those standards were so intended and should be so read, for the same reasons that we think the *Cohen* exception was intended to be narrowly construed, which we set out below.

ture will render the appellate court's decision fruitless later in the lawsuit.

We are clear that a class certification order does not fall within *Cohen*. The finality condition is not met, as such an order is not a final determination of the propriety of a class. Under Fed.R.Civ. P.23(c)(1), a class must be certified as soon as practicable after commencement of the action, and is made conditional and subject to alteration, to the creation of sub-classes, Rule 23(c)(4)(B), or indeed to decertification as the suit progresses and newly discovered facts warrant.[10] Nor is the class issue separable from the merits in all cases (including this one). The common questions, typicality, conflicts and adequacy of representation, Fed.R.Civ.P. 23(a), and predominance tests, Fed.R.Civ.P. 23(b)(3), are determinations (unlike, for example, the notice question involved in *Eisen IV*) which may require review of the same facts and the same law presented by review of the merits.[11]

Nor, for that matter, does the order threaten the defendant with any irreparable harm cognizable under *Cohen*. The defendant does not lose any legal rights or entitlement in the interim between certification and appeal—appeal after the litigation fully protects from a judgment for an improper class. *See* Geo.Wash. Note, *supra*, at 628-630.

The Second Ciruit found the requisite injury in the increased, and generally irrecoverable, costs of defending the class action. With deference, we disagree. The final decision rule itself often increases the time and cost of litigation. Denial of immediate

10. "But we do not mean that every order fixing security is subject to appeal. Here it is the right to security that presents a serious and unsettled question. If the right were admitted or clear and the order involved only an exercise of discretion as to the amount of security, a matter the statute makes subject to reconsideration from time to time, appealability would present a different question." *Cohen*, at 547, 69 S.Ct. at 1226.

11. *See Kohn, supra*, at 1099; *General Motors Corp., supra*, at 659. In fact, as a ruling on class certification must be made soon after commencement of the action, the facts governing the class determination will inevitably be less clear than after the case has gone to judgment.

review from orders denying motions to dismiss, Fed.R.Civ.P. 12(b)(6), or for summary judgment, Fed.R.Civ.P. 56, may subject a defendant in particular cases to defense cost equivalent to those incurred in defending a class action. Geo.Wash. Note, *supra*, at 629-630; *Kohn v. Royall, Koegel & Wells*, 496 F.2d 1094, 1098-1099 (2d Cir. 1974). Such litigants must bear those costs because of the legislative judgment that a final decision rule will most benefit all litigants, statutorily foreclosing reliance on litigation costs as a justification for departure from the final decision rule.[12]

It strikes us that the Second Circuit rule is the product of three policy considerations, urged on us here as well, which we conclude are insufficient to justify departure from the *Cohen* gloss on the rule.

The first is that litigation costs will be reduced by allowing appeal and thus avoiding the substantial costs of litigating an improperly certified class. While perhaps true in a particular suit, we suspect that the savings envisioned may well prove illusory. Applied to all class actions, the Second Circuit's rule saves time and money only when the appellate court determines the particular class certification order is appealable, when the order would not have been otherwise appealable under the narrower *Cohen* exception, when the district judge would have refused to certify a § 1292(b) appeal, where the district judge would not later decertify the class, and where, on the merits, the order is reversed. Even then, later developments in the suit may lead to reinstatement of the class. To be balanced against savings is the loss of time and money resulting from appeal in which the order is held non-appealable, or the order is affirmed. Neither we nor (we suggest) the Second Circuit have any way of striking that balance. We can only speculate concerning the various costs, time spans,

12. Neither *Cohen* nor *Eisen IV* support the Second Circuit in this regard. In both cases the defendant was threatened with costs which the applicable statute placed on the plaintiff. In neither case did the Court rely on general litigation expense to justify appealability.

and percentages which must necessarily be appraised to determine whether the Second Circuit's exception could pay its way; it is ultimately a question which is best suited to legislative investigation and judgment.

Moreover, we would suggest that the number of suits in which a rule of appealability would be worthwhile may be relatively small. The standard of review is abuse of discretion. A number of the criteria set out in Rule 23 relate to matters, such as manageability, adequacy of representation, feasibility of joinder, superiority to other available methods of adjudication, and the like, which are much more within the knowledge of the district court in touch with the litigation than in ours; our review is unlikely to add any superior wisdom, or to reverse on those grounds. In those cases which turn on a question of law, the district judge may certify an interlocutory appeal.[13] The number of cases in which massive litigation costs are threatened, in which a district judge declines to certify an appeal, and which thereafter results in reversal of the class certification, may prove small indeed.

The second consideration is that, because the "death knell" doctrine allows plaintiffs to appeal order denying class status, parity of treatment requires that defendants be allowed to appeal orders granting such status. We disagree. Precisely the same disparity exists between plaintiffs and defendants with regard to summary judgment or motion to dismiss orders. So long as they are differently situated in a manner relevant to the purposes of the final decision rule, plaintiffs and defendants may be treated differently. Suffice it here to say that they are differently situated with respect to the finality of the class order—an order denying in the "death

13. Generally an order granting class action status does not involve a controlling question of law when entered because it has no significant effect on the litigation until issues not pertaining to the personal claims of the class representative have to be decided. Note, *Interlocutory Appeals in the Federal Courts Under 28 U.S.C. § 1292(b),* 88 Harv.L.Rev. 607, 630-631 n. 97 (1975).

knell" situation effectively terminates the suit and precludes presentation of the merits; an order granting does not end the suit, or preclude presentation of the defense, and is subject to reevaluation as well. *See* Geo. Wash. Note, *supra,* at 631-632.

The final consideration relied on by the Second Circuit, *see Herbst, supra,* at 1313, strenuously urged here, is that a class certification order in a large-class, small-claim class action threatens such ruinous liability that the defendant inevitably must settle even frivolous claims, thereby effectively precluding review of the crucial class certification order unless interlocutory review is allowed. Again, we are unpersuaded. In large part the argument is an attack on the decision reflected in Rule 23 to allow integration of numerous small individual claims into a single powerful unit, rather than to an attack peculiarly germane to the operation of the final decision rule in the class action context. Precisely the same power to coerce a settlement (and defeat review of potentially erroneous previous orders) is wielded by any plaintiff with a substantial claim—that fact alone does not generally confer appealability on an order which effectively requires a defense to a large claim. The fairness of the pressure—*i.e.,* the sociological merits of the small claims class action—is not a question for us to decide. The fact is that Congress, by authorizing and approving Rule 23(b)(3), created a vehicle to put small claimants in an economically feasible litigating posture. In that light, we doubt the propriety of an attendant judicial alteration of the final decision rule which immediately (and uniquely) subjects redress of class plaintiffs' claims to the delay and cost of an appeal.

We recognize, of course, that it is the class certification order itself which, if erroneous, creates the improper coercive effect. That is a distinction without a difference unless class certification orders have unique effects specially implicating the policy of the final decision rule. It may well be that a higher percentage of class certification orders are erroneous than others which subject a de-

fendant to the coercion of a large potential liability; or that a higher percentage of frivolous claims are presented in class actions than in others; or that the magnitude of the potential liability in class actions is leading to settlement of more frivolous claims and abandonment of more meritorious appeals, than occurs in other litigation. If such is not the case, there is no reason to treat a class certification order differently than any other interlocutory order. If so, an exception may or may not be justified.[14]

In either event, however, the argument is again properly addressed to Congress. We have no reliable knowledge,[15] and no good means of acquiring any, about the present nature and number of class action settlements, and of how that experience compares with individual lawsuits of the same type, or pressing claims of similar magnitude. Thus, we have no means of deciding whether the present hue and cry of "blackmail" in fact reflects an abnormally high incidence of unfairly coerced settlements, or is rather the pained outcry of defendants whose previously advantaged litigating position has been undermined, and who must now con-

14. We note that the supposed *in terrorem* effect of the class certification will persist despite a right of immediate appeal—the claim may be frivolous and the class proper. Immediate appeal will eliminate only the improperly certified coercive class action, at the expense of both frivolous and non-frivolous, property [sic] certified classes. It may well be better to attack the "blackmail" problem directly with appropriate safeguards rather than collaterally undermining the final decision rule.

15. Both sides have cited extensive commentary, by courts and critics alike, on the supposed *in terrorem effect* of class actions. Almost inevitably those opinions are supported by highly inconclusive, or no, empirical evidence; most of the debate is founded on speculation, primarily dictated by the writer's personal experience and feelings for or against class actions. The empirical evidence on the subject is very limited, and not particularly helpful because it provides no basis for comparison of class actions with other suits. For what it is worth, however, the empirical evidence indicates that a relatively high proportion of class actions are not settled, but disposed of in defendant's favor on preliminary motions. *See* Committee on Commerce, United States Senate, *Class Action Study*, 93d Cong., 2d Sess. (1974), Committee Print at 9-10. On the basis of the evidence before it, the Commerce Committee concluded that the class action was not a particularly effective vehicle for coercing settlements.

front small claimants (who have been given the capacity to exert pressure proportionate to the magnitude of the total injury occasioned by defendant's alleged violation of the law) on more equal grounds. Without such knowledge, there is no justification for departure from the "final decision" rule in this context, and we decline to do so.

Consequently, the §-1291 appeals designated Nos. 74-2141, 74-2167, 74-2341 and 74-2466 are dismissed.

II. *The § 1292(b) interlocutory appeals.*

We deny the motion to dismiss the § 1292(b) appeals.

The prosecution of these appeals has not been a model of diligence. Defendants were granted an extension of the time to transmit the record, and three extensions in the briefing schedule. Some of those delays could have been avoided; while the issues involved are somewhat complex, we note that much of the material in the appellate briefs was presented to the trial court, and that the lawyers did not start from scratch here.

However, the motion to dismiss is addressed to our discretion, and we think dismissal is not mandated in this case. From the somewhat conflicting representations before us it appears that appellees may have agreed to the extensions, although that acquiescence may have been induced by a now disclaimed representation that plaintiffs could continue with discovery while the case was on appeal. Because the record is hazy, because we have granted the extensions, and because the issues have now been briefed and argued and are ripe for decision, we think the preferable course is for us to decide the appeal and provide guidance to the trial court. However, we do note that one purpose of interlocutory appeals is to hasten the conclusion of a lawsuit, that briefing extensions defeat that purpose, and that in appropriate circumstances we can deny unwarranted extensions and dismiss appeals to prevent an interlocutory appeal from being misused as a dilatory tactic.

We turn to the merits of defendants' Buchan and Roberts, and Blackie, et al., § 1292(b) appeals.

III. *Compliance with the Requirements of Fed.R.Civ.P. 23(a) and (b)(3).*

A. The court's approach to class certification.

As a preliminary matter, we face the contention that the district judge certified the class in an inappropriate manner. Relying on our opinion in *In re Hotel Telephone Charges*, 500 F.2d 86, 90 (9th Cir. 1974) defendants argue that he improperly engaged in speculation when determining whether a common question exists, and whether conflicts make class representation inadequate, rather than determining, before certifying the class, that the requirements of the Rule were in fact met. We disagree.

From a thorough review of the district judge's opinion, we think it apparent that he analyzed the allegations of the complaint[16] and the other material before him (material sufficient to form a reasonable judgment on each requirement), considered the nature and range of proof necessary to establish those allegations, determined as best he was able the future course of the litigation, and then determined that the requirements were met at that time.[17] That is all that is required.

16. In large part appellants' attack on the district judge's approach is a reiteration of their disagreement with his legal conclusions. The speculative language seized upon in the opinion simply conditions the conclusion that a common question exists on plaintiffs' proof of the allegations—*i.e.*, if plaintiffs prove their allegation of X, X will be a question of fact or law common to the class. Such speculation is entirely proper and necessary. Likewise, the court ruled that any conflicts at present did not appear to defeat adequacy of representation, but that if any unforeseen difficulties arose, they could be cured by sub-classes—again a proper application of the Rule.

17. The court is bound to take the substantive allegations of the complaint as true, thus necessarily making the class order speculative in the sense that the plaintiff may be altogether unable to prove his allegations. While the court may not put the plaintiff to preliminary proof of his claim, it does require sufficient information to form a reasonable judgment. Lacking that, the court may request the parties to supplement the pleadings with sufficient material to allow an informed judgment on each of the Rule's requirements.

Defendants misconceive the showing required to establish a class under *Hotel Telephone Charges*. We indicated there that the judge may not conditionally certify an improper class on the basis of a speculative possibility that it may later meet the requirements. 500 F.2d at 90. However, neither the possibility that a plaintiff will be unable to prove his allegations, nor the possibility that the later course of the suit might unforeseeably prove the original decision to certify the class wrong, is a basis for declining to certify a class which apparently satisfies the Rule. The district judge is required by Fed.R.Civ.P. 23(c)(1) to determine "as soon as practicable after the commencement of an action brought as a class action . . . whether it is to be so maintained." The Court made clear in *Eisen IV* that that determination does not permit or require a preliminary inquiry into the merits, 417 U.S. at 177-178, 69 S.Ct. 1221; thus the district judge is necessarily bound to some degree of speculation by the uncertain state of the record on which he must rule. An extensive evidentiary showing of the sort requested by defendants is not required. So long as he has sufficient material before him to determine the nature of the allegations, and rule on compliance with the Rule's requirements, and he bases his ruling on that material, his approach cannot be faulted because plaintiffs' proof may fail at trial. Of course, whether he applied correct legal principles in making the ruling, and whether the ruling was within the permissible boundaries of the discretion vested in him, is another question, to which we now turn.

B. *The merits of class certification.*

Defendants question this suit's compliance with each of the various requirements of Rule 23(a) and (b)(3)[18] except numer-

18. Rule 23 provides in part:

"(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to

osity (understandably, as it appears that the class period of 27 months will encompass the purchasers involved in about 120,000 transactions involving some 21,000,000 shares). However, all of defendants' contentions can be resolved by addressing 3 underlying questions: 1) whether a common question of law or fact unites the class; 2) whether direct individual proof of subjective reliance by each class member is necessary to establish 10b-5 liability in this situation; and 3) whether proof of liability or damages will create conflicts among class members and with named plaintiffs sufficient to make representation inadequate? We turn to the first issue.

1. *Common questions of law or fact.*

The class certified runs from the date Ampex issued its 1970 annual report until the company released its 1972 report 27 months later. Plaintiffs' complaint alleges that the price of the company's stock was artifically inflated because:

> "the annual reports of Ampex for fiscal years 1970 and 1971, various interim reports, press releases and other documents (a) overstated earnings, (b) overstated the value of inventories and other assets, (c) buried expense items and other costs incurred for research and development in inventory, (d) misrepresented the companies' current ratio, (e) failed to establish adequate reserves for receivables, (f) failed to write off certain assets, (g) failed to account for the proposed discontinuation of certain product lines, (h) misrepresented Ampex's prospects for future earnings."

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the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

"(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

* * * * * *

"(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

The plaintiffs estimate that there are some 45 documents issued during the period containing the financial reporting complained of, including two annual reports, six quarterly reports, and various press releases and SEC filings.

Because the alleged misrepresentations are contained in a number of different documents, each pertaining to a different period of Ampex's operation, the defendants argue that purchasers throughout the class period do not present common issues of law or fact. They reason that proof of 10b-5 liability will require inspection of the underlying set of facts to determine the falsity of the impression given by any particular accounting item presented; that the underlying facts fluctuate as the business operates (*i. e.*, inventory is bought and sold, accounts are paid off and created); thus, proof of the actionability of a current accounting representation or omission will apply only to those who purchased while a financial report was current; from which they conclude no common question is presented and a class is improper.

We disagree. The overwhelming weight of authority holds that repeated misrepresentations of the sort alleged here satisfy the "common question" requirement. Confronted with a class of purchasers allegedly defrauded over a period of time by similar misrepresentations, courts have taken the common sense approach that the class is united by a common interest in determining whether a defendant's course of conduct is in its broad outlines actionable, which is not defeated by slight differences in class members' positions, and that the issue may profitably be tried in

one suit. *See Green v. Wolf Corporation*, 460 F.2d 291, 298 (2d Cir. 1968); *Esplin v. Hirschi*, 402 F.2d 94 (10th Cir. 1968); *Harris v. Palm Springs Alpine Estates*, 329 F.2d 909 (9th Cir. 1964); *U. S. Financial Securities Litigation*, 64 F.R.D. 443 (S.D. Cal. 1974); *Aboudi v. Daroff*, 65 F.R.D. 388 (S.D.N.Y.1974); *Werfel v. Kramarsky*, 61 F.R.D. 674 (S.D.N.Y.1974); *In re Memorex Security Cases*, 61 F.R.D. 88 (N.D.Cal.1973); *Siegel v. Realty Equities Corporation of New York*, 54 F.R.D. 420 (S.D.N.Y.1972); *Herbst v. Able*, 47 F.R.D. 11 (S.D.N.Y.1969); *Dolgow v. Anderson*, 43 F.R.D. 472 (E.D.N.Y.1968); *Siegel v. Chicken Delight, Inc.*, 271 F.Supp. 722 (N.D.Cal.1967); *Fischer v. Kletz*, 41 F.R.D. 377, 381 (S.D.N.Y.1966); *Kronenberg v. Hotel Governor Clinton, Inc.*, 41 F.R.D. 42 (S.D.N.Y.1966). As we stated in *Harris, supra:*

> "Appellees assert that the various investors made payments on the securities at different times and stand in different positions . . . [S]ince the complaint alleges a common course of conduct over the entire period directed against all investors, generally relied upon, and violating common statutory provisions, it sufficiently appears that the questions common to all investors will be relatively substantial." 329 F.2d at 914.

Those views are consistent with the views of the Advisory Committee on the Rule: "[A] fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action . . ." Advisory Committee on Rule 23, Proposed Amendments to the Rules of Civil Procedure, 39 F.R.D. 69, 103 (1966). The availability of the class action to redress such frauds has been consistently upheld, *see In re Caesars Palace Securities Litigation*, 360 F.Supp. 366, 395-96 (S.D. N.Y.1973), in large part because of the substantial role that the deterrent effect of class actions plays in accomplishing the objectives of the securities laws. *See* III Loss, Securities Regulation 1819

(2d ed. 1961) ("the ultimate effectiveness of [the security antifraud laws] may depend on the applicability of the class action device").

While the nature of the interrelationship and the degree of similarity which must obtain between different representations in order to come within the outer boundaries of the "common course of conduct" test is somewhat unclear,[19] the test is more than

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19. Because plaintiffs have alleged specific strands of misrepresentation running throughout financial statements of the class period, they are well within whatever the outer boundaries might be, and we need not resolve the issue. We note, however, that a number of courts have apparently held that allegations simply that earnings and stock price have been inflated over a period of time by a defendant's misrepresentations is sufficient to satisfy the common question requirement (although the cases are somewhat unclear because they fail to specify the precise misrepresentations which allegedly inflated earnings). *See Fischer v. Kletz, supra; Krongnberg, supra; Werfel v. Kramarsky, supra. See Feldman v. Lifton,* 64 F.R.D. 539, at 544-545 (S.D.N.Y. 1974). Appellants point out that allegation of inflation of earnings or price is conclusionary, and may derive from altogether unrelated misrepresentations. In their view the common question requirement is met only if all purchasers are injured by the same misrepresentation, or, in a "course of conduct" case, by identical repeated misrepresentations, and if defendant's liability can be established by proof both of the same set of facts and same legal principle. We think that is far too restrictive a view of the common question requirement in the securities fraud context. Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; it may also be predicated on a "practice, or course of business which operates . . . as a fraud . . ." Under that section class members may well be united in establishing liability for fraudulently creating an illusion of prosperity and false expectations,

Moreover, even when misrepresentations are unrelated, class members may share a common question of law or fact. Of course, if an early misrepresentation is undissipated, a later purchaser will present a common question even if another misrepresentation has intervened. But even if the effect of the earlier misrepresentation is dissipated, proof of the earlier misrepresentation may be relevant to the latter purchaser's case. Proof of the earlier fraud and its effects might be relevant circumstantially to establish duty standards, culpability, or damages regarding the later fraud; it would establish background information about the defendant common to both suits. Thus, even when unrelated misrepresentations are alleged as part of a common scheme, class members may share common factual questions, and trial in the same forum avoids duplicative proof. That is a major purpose of a class action; the "common question" requirement

satisfied when a series of financial reports uniformly misrepresent a particular item in the financial statement. In that situation, the misrepresentations are "interrelated, interdependent, and cumulative;" "[l]ike standing dominoes . . . one misrepresentation . . . cause[s] subsequent statements to fall into inaccuracy and distortion when considered by themselves or compared with previous misstatements." *Fischer v. Kletz, supra,* at 381.

Precisely such a situation is alleged here in at least three respects—the failure to create adequate reserves for uncollectible accounts receivable and for contractually guaranteed royalty payments, and the overstatement of inventory. The 1972 Annual Report shows writedowns of $31.9 million as provision for royalty guarantees, $11.8 million for uncollectible accounts receivable, and $15 million for inventory. Plaintiffs allege that the writedowns had roots tracing back to the beginning of the class period, an allegation somewhat borne out by the auditors' withdrawal of certification of the 1971 report because of uncertainty that the huge losses reported in 1972 were the product of 1972 business operations, and not attributable to earlier years. Plaintiffs contend that the company's financial reports throughout the period uniformly and fraudulently failed to establish reserves in amounts adequate to satisfy accepted accounting principles, injuring all purchasers of the consequently inflated stock.

should be interpreted to obtain that objective. Naturally, when the component misrepresentations of a "course of conduct" fraud are unrelated, a great many more non-common questions exist. In that situation no representative's claim may be typical of the rest of the class, Rule 23(a)(3), although that depends on how broadly that requirement is construed. *See* text at note 25, *infra,* and note 25 *infra.* We think it is for the predominance and other requirements of Rule 23(b)(3), rather than the common question requirement, to function to keep the balance between the economies attained and lost by allowing a class action. The common question requirement should not be restrictively interpreted to attain that objective, particularly as to do so would eliminate the class action deterrent for those who engage in complicated and imaginative rather than straightforward schemes to inflate stock prices.

In this aspect, plaintiffs allege a source of inflation common to every purchaser. The creation of a reserve is of course simply an adjustment made to the balance sheet and income statement to provide a more realistic view of the business and its operations. Failure in any particular period to recognize that a portion of the accounts receivable generated in that period are uncollectible, and to create or adjust a reserve, will have the effect of inflating the balance sheet assets and surplus, and overstating the income for the period; likewise failure to recognize accrued liabilities for royalty payments will inflate surplus by understating liabilities, and will overstate income. Naturally, any inflation in the stock price due to inadequate reserves will persist until the reserves become adequate or until the losses are in fact written off.

Defendants nevertheless contend that a class is improper because each purchaser must depend on proof of a different set of accounting facts to establish the inadequacy of the reserves at the time he bought. Defendants misconceive the requirement for a class action; all that is required is a common issue of law *or* fact. Even were we to assume that the reserves were at some points during the period adequate, the class members still would be united by a common interest in the application to their unique situation of the accounting and legal principles requiring adequate reserves—*i. e.,* by a common question of law.[20] Here,

20. Appellants make much of the distinction between an accounting principle and estimate, arguing that the exercise of judgment involved in an estimate depends on analysis of facts which change, making legal evaluation of different estimates distinct legal and factual problems. The distinction makes little sense in this context. The judgment necessary to make an estimate must be controlled by the accounting principle. Thus, even when only detached, unconnected incidents of incorrect estimates are alleged, the jury must nevertheless be apprised of the common standard of law by which to judge the estimates—the accounting principle—and a common question is presented. Insofar as a class action is involved, the situation is the same as where a consistent misapplication of an accounting principle as part of a course of conduct to inflate the stock price is alleged. And, moreover, it appears to us, contrary to appellants' contentions, that plaintiffs are complaining of abuses of accounting principles, not estimates.

however, in light of the progressive deterioration of Ampex's financial position and the magnitude of the losses at the end of the period, even the fact that reserves were in reality inadequate throughout much if not all of the period may not be in serious dispute; rather, the question will be whether the inadequacy was in some sense culpable because the contingencies which proved them inadequate were foreseen or foreseeable.

The alleged inventory overvaluation likewise presents common issues. Defendants again contend it does not because the valuation of any particular period's closing inventory involves a process of physical estimation based on that inventory's characteristics, and that overstatement of one period's closing inventory, while overstating that period's income, will have an opposite effect on the next period's income by overstating opening inventory, deflating rather than inflating stock price. While true in the abstract, appellants' position disregards the real substance of the plaintiffs' complaint which is again highlighted by the 1972 Report. In explaining the $15 million writedown, the company stated: "Inventories of stereo tapes more than six months old and more than one year old were written down 50% and 100% respectively . . . No significant writedown of this nature were made in the prior year."

Plaintiffs thus are complaining of the balance sheet effect of inventory overvaluation. They are alleging that by failing throughout the class period to recognize and account for inventory obsolescence each time the inventory was valued, the company consistently inflated the value at which it carried inventory on the balance sheet.[21] In effect, plaintiffs are complaining of a consistent disregard of the accounting principle that inventory be valued at "lower of cost or market." Again, common questions of law and facts are presented.

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21. Whether inflation of assets rather than earnings is material to the stock price is for the jury, not us, to decide.

The class members also share an interest in establishing the standard of care required of the various defendants under the *White v. Abrams,* 495 F.2d 724 (9th Cir. 1974), flexible duty standard. The flexible duty of any defendant, while depending on his particular relationship to Ampex and to the financial reporting involved, will be owed identically to all market purchasers, who are for practical purposes identically situated. The culpability of each defendant's conduct is to be measured against the statutorily imposed duty not to manipulate the market. Differences in sophistication, etc., among purchasers have no bearing in the impersonal market fraud context, because dissemination of false information necessarily translate through market merchanisms into price inflation which harms each purchaser identically. *See U.S. Financial Securities Litigation, supra,* at 451-452.

Moreover, because of the relative similarity of the various documents involved, the duty owed by a defendant with respect to such documents will probably be uniform or nearly so, further uniting the positions of all class purchasers.

2. *Predominance and reliance.*

Defendants contend that any common questions which may exist do not predominate over individual questions of reliance and damages.

The amount of damages is invariably an individual question and does not defeat class action treatment. *E. g., U.S. Financial Securities Litigation, supra,* at 448 n. 5, and cases there cited. Moreover, in this situation we are confident that should the class prevail the amount of price inflation during the period can be chartered and the process of computing individual damages will be virtually a mechanical task. *See* n. 24 *infra.*

Individual questions of reliance are likewise not an impediment —subjective reliance is not a distinct element of proof of 10b-5 claims of the type involved in this case.

The class members' substantive claims either are, or can be, cast in omission or non-disclosure terms—the company's financial reporting failed to disclose the need for reserves, conditions reflecting on the value of the inventory, or other facts necessary to make the reported figures not misleading. The Court has recognized that under such circumstances

> "involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." (citations omitted)

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153-154, 92 S.Ct. 1456, 1472, 31 L.Ed.2d 741 (1972). *See U. S. Financial Securities Litigation, supra,* at 451; *Caesars Palace Securities Litigation, supra,* at 399; *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1344 (E.D.Penn.1972).

Moreover, proof of subjective reliance on particular misrepresentations is unnecessary to establish a 10b-5 claim for a deception inflating the price of stock traded in the open market. *See Herbst v. I. T. T., supra,* at 1315-1316; *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.,* 480 F.2d 341, 373-374 (2d Cir. 1973); *Tucker v. Arthur Andersen & Co.,* 67 F.R.D. 468, at 480 (S.D.N.Y. 1975); *U. S. Financial Securities Litigation, supra,* at 449-451; *Werfel v. Kramarsky, supra,* at 681; *In re Memorex Security Cases, supra,* at 100-101; *Siegel v. Realty Equities Corporation of New York, supra,* at 424-425; *Herbst v. Able, supra,* at 20. Proof of reliance is adduced to demonstrate the causal connection between the defendant's wrongdoing and the plaintiff's loss. We think causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of misrepresentations, without direct proof of reliance. Materiality circumstantially

establishes the reliance of some market traders and hence the inflation in the stock price—when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case. *See In re Memorex Security Cases, supra,* at 101; Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5,* 88 Harv.L.Rev. 584, 593 (1975).

Defendants argue that proof of causation solely by proof of materiality is inconsistent with the requirement of the traditional fraud action that a plaintiff prove directly both that the reasonable man would have acted on the misrepresentation (materiality), and that he himself acted on it, in order to establish the defendant's responsibility for his loss, which justifies the compensatory recovery.

We disagree. The 10b-5 action remains compensatory; it is not predicated solely on a showing of economic damage (loss causation). We merely recognize that individual "transactional causation" can in these circumstances be inferred from the materiality of the misrepresentation, *see Tucker v. Arthur Andersen & Co., supra,* at 480; *Schlick v. Penn-Dixie Cement Corp.,* 507 F.2d 374, 381-382 (2d Cir. 1974), and shift to defendant the burden of disproving a prima facie case of causation. Defendants may do so in at least 2 ways: 1) by disproving materiality or by proving that, despite materiality, an insufficient number of traders relied to inflate the price; and 2) by proving that an individual plaintiff purchased despite knowledge of the falsity of a representation, or that he would have, had he known of it.[22]

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22. A number of cases indicate that proof of materiality raises "presumption" of reliance. The Court did not speak of a presumption in *Mills* or *Affiliated Ute;* we prefer to recognize that materiality directly establishes causation more likely than not, and that reliance as a separate requirement is simply a milepost on the road to causation. The net result is in either view the same; the validity of either view turns on the assumption that the particular investor is more likely to act like the reasonable investor than not.

There is some debate as to whether the "presumption" of reliance may be rebutted; the general view is that it may be, *see* Harvard Note, *supra,* at 600 and 600 n. 75, and cases there cited, although sound contrary opinion exists. *See Herbst v. ITT, supra,* at 1316 n. 14; *Chris-Craft Industries, Inc., supra,* at 400 (Mansfield, J., concurring and dissenting). The 10b-5 private suit serves a public purpose, but has done so since its judicial creation in the farmework of a private damage suit. We doubt the right to disprove causation will substantially reduce a defendant's liability in the open market fraud context, as we doubt that a defendant would be able to prove in many instances to a jury's satisfaction that a plaintiff was indifferent to a material fraud. Nevertheless, we think the public purpose can be adequately served within the traditional compensatory suit framework by limiting recoveries to those who are in fact injured, and excluding those whom a defendant proves have not been injured, and that 10b-5 suits should continue in that mold until a contrary need appears or until the Court directs otherwise.

The right of rebuttal, however, does not preclude the predominance of common questions. Causation as to each class member is commonly proved more likely than not by materiality. That showing will undoubtedly be conclusive as to most of the class. The fact that a defendant may be able to defeat the showing of causation as to a few individual class members does not transform the common question into a multitude of individual ones; plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all.

The right to disprove causation will not render the action unmanageable. A defendant does not have unlimited rights to discovery against unnamed class members; the suit remains a representative one. *See Clark v. Universal Builders, Inc.,* 501 F.2d 324 (7th Cir. 1974); *Gardner v. Awards Marketing Corporation,* 55 F.R.D. 460 (D.Utah 1972); *Fischer v. Wolfinbarger,* 55 F.R.D. 129 (W.D.Ky. 1971). The district judge may reasonably control discovery to keep the suit within manageable bounds, and to prevent fruitless fishing expeditions with little promise of success. He may also exercise discretion in the conduct of the trial, to prevent a time-consuming series of mini-trials on causation, by limiting introduction of repetitive evidence, or by limiting evidence to instances where causation is in doubt; he may also postpone trial of the rebuttal of individual causation until the damage stage of the trial; indeed, he has extensive powers to expedite the suit with procedural innovations. *See* Rule 23(d). We think procedures can be found and used which will provide fairness to the defendants and a genuine resolution of disputed issues while obviating the danger of subverting the class action with delaying and harassing tactics. If not, we may have to reconsider whether to make proof of causation from materiality conclusive, keeping in mind that the Court has directed that the statute be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an overinclusive recovery to a defrauded class if the unavailability of the class device renders the alternative a grossly underinclusive recovery.

That the prima facie case each class member must establish differs from the traditional fraud action, and may, unlike the fraud action, be established by common proof, is irrelevant; although derived from it, the 10b-5 action is not coterminous with a common law fraud action. As we recently recognized in *White v. Abrams*, the fraud action must be and has been flexibly adopted to the overriding purpose of enforcing the Federal securities laws. 495 F.2d at 731. *See Affiliated Ute, supra,* at 151; *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 123 (1971); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186, 195, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963).

Here, we eliminate the requirement that plaintiffs prove reliance directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden. A purchaser on the stock exchanges may be either unaware of a specific false representation, or may not directly rely on it; he may purchase because of a favorable price trend, price earnings ratio, or some other factor. Nevertheless, he relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the price he pays reflects material misrepresentations. Requiring direct proof from each purchaser that he relied on a particular representation when purchasing would defeat recovery by those whose reliance was indirect, despite the fact that the causational chain is broken only if the purchaser would have purchased the stock even had he known of the misrepresentation. We decline to leave such open market purchasers unprotected. The statute and rule are designed to foster an expectation that securities markets are free from fraud—an expectation on which purchasers should be able to rely.

Thus, in this context we think proof of reliance means at most a requirement that plaintiff prove directly that he would have acted differently had he known the true facts. That is a requirement of proof of a speculative negative (I would not have bought had I known) precisely parallel to that held unnecessary in *Affiliated Ute* and *Mills* (I would not have sold had I known). We reject it here for the same reasons. Direct proof would inevitably be somewhat pro-forma, and impose a difficult evidentiary burden, because addressed to a speculative possibility in an area where motivations are complex and difficult to determine. That difficulty threatens to defeat valid claims—implicit in *Affiliated Ute* is a rejection of the burden because it leads to underinclusive recoveries and thereby threatens the enforcement of the securities laws. *See* Harv. Note, *supra*, at 590-91. Here, the requirement is redundant—the same causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.[23] Under those circumstances we think it appropriate to eliminate the burden.

Defendants contend that elimination of individual proof of subjective reliance alters and abridges their substantive rights in violation of the Rules Enabling Act, 28 U.S.C. § 2072. The obvious answer is that the standards of proof of causation we have set out apply to all fraud on the market cases, individual

23. *Raschio v. Sinclair*, 486 F.2d 1029 (9th Cir. 1973), is in no way inconsistent with our present position. There we dealt with the statutory "in connection with" requirement, and held that it could not be met as a matter of law when the stock was purchased two months before the allegedly fraudulent representation was made. Here we do not retreat from that position, or from the implicit requirement set out there that there be a reasonable transactional nexus between the fraud and the loss—we simply amplify on the manner in which that nexus may be proved.

as well as class actions. No interpretation of Rule 23 is involved, and the Rules Enabling Act limitation is not implicated.[24]

C. *Conflicts*

Defendants' final major argument is that conflicts among class members preclude class certification. They contend that the interests of class members in proving damages from price inflation (and hence the existence and materiality of misrepresentations subsumed in proving inflation) irreconcilably conflict, because some class members will desire to maximize the inflation existing on a given date while others will desire to minimize it. For example, they posit that a purchaser early in the class period who later sells will desire to maximize the deflation due to an intervening corrective disclosure in order to maximize his out of pocket damages, but in so doing will conflict with his purchaser, who is interested in maximizing the inflation in the price he pays. We agree that class members might at some point during this litigation have differing interests. We altogether disagree, for a spate of reasons, that such potential conflicts afford a valid reason at this time for refusing to certify the class.

Defendants' position depends entirely on adoption of the out of pocket loss measure of damages, rather than a rescissory measure. Under the out of pocket standard each purchaser recovers the difference between the inflated price paid and the value received, plus interest on the difference. If the stock is resold at an inflated price, the purchaser-seller's damages, limited by § 28(a) of the Act, 15 U.S.C. § 78bb(a) to "actual damages," must be diminished by the inflation he recovers from his purchaser. Thus, he is interested in proving that some intervening event, such as a corrective

24. Indeed, we could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation (*i. e.*, economic damage) regardless of transactional causation, without implicating the Enabling Act limitation.

release, had diminished the inflation persisting in the stock price when he sold.[25]

While out of pocket loss is the ordinary standard in a 10b-5 suit, *Foster v. Financial Technology, Inc.*, 517 F.2d 1068, at 1071 (9th Cir. 1975); *Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir. 1965); *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962); *Abrahamson v. Fleschner*, 392 F.Supp. 740, at 746 (S.D.N.Y.1975); *see Sigafus v. Porter*, 179 U.S. 116, 123, 21 S.Ct. 34, 45 L.Ed. 113 (1900); *Smith v. Bolles*, 132 U.S. 125, 10 S.Ct. 39, 33 L.Ed. 279 (1889); Note, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities*, 26 Stan.L.Rev. 371, 383-384 (1974); 3 A. Bromberg, Securities Law, Fraud—Rule 10b-5, § 9.1, at 226-227 (1974), it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure, *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1173 (2d Cir. 1970); *Abrahamson v. Fleschner, supra*, at 746; *see* Stanford Note,

25. Appellants contend that the inflation paid must be measured by the change in price after a corrective release. That drop is of course circumstantial evidence of the inflation when purchased, but it is not the exclusive method of measuring inflation. The fact finder may rely on other methods of determining actual value on the date of purchase, including expert testimony on actual value derived from capitalization of earnings techniques or testimony on book value. Particularly where, as here, the amount of inflation due to absence or insufficiency of reserves may fluctuate, such evidence is necessary in the absence of corrective releases. In any event, the drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period. Stanford Note, *infra*, at 384-385; *Tucker v. Arthur Andersen & Co., supra*, at 482. However, from an appropriate mix of the various methods we are confident that the jury will be able to trace a graph delineating the actual value of the stock throughout the class period. When compared with a comparable graph of the price the stock sold at, the determination of damage will be a mechanical task for each class member.

supra, at 374-376; A. Bromberg, *supra*, at 226, or to allow consequential damages. *Foster, supra*, at 3; *Zeller v. Bogue Elec. Mfg. Co.*, 476 F.2d 795, 802-803 (2d Cir. 1973). It is for the district judge, after becoming aware of the nature of the case, to determine the appropriate measure of damages in the first instance; the possible creation of potential conflicts by that decision does not render the class inappropriate now. The Rule provides the mechanism of subsequent creation of subclasses, Rule 23(c)(4), to deal with latent conflicts which may surface as the suit progresses. *Green v. Wolf Corporation, supra*, at 299; *Tucker v. Arthur Andersen & Co., supra*, at 482; *Handwerger v. Ginsberg*, CCH Fed.Sec.L.Rep. ¶ 94,934, at 97,241 (S.D.N.Y.1975); *Caesars Palace Securities Litigation, supra*, at 398; *Sol S. Turnoff v. N. V. Nederlandsche Combinatie Voor Chemische Industrie*, 51 F.R.D. 227, 233 (E.D.Pa.1970). As a result, courts have generally declined to consider conflicts, particularly as they regard damages, sufficient to defeat class action status at the outset unless the conflict is apparent, imminent, and on an issue at the very heart of the suit. *See Hawk Industries, Inc. v. Bausch & Lomb, Inc.*, 59 F.R.D. 619 (S.D.N.Y. 1973); *Siegel v. Realty Equities Corporation of New York, supra*, at 426.

Here, the conflict, if any, is peripheral, and substantially outweighed by the class members' common interests. Even assuming *arguendo* that the out of pocket standard applies, the class is proper. Every class member shares an overriding common interest in establishing the existence and materiality of misrepresentations. The major portion of the inflation alleged is attributed to causes which allegedly persisted throughout the class period. It will be in the interest of each class member to maximize the inflation from those causes at every point in the class period, both to demonstrate the *sine qua non*—liability—and to maximize his own potential damages—the more the stock is inflated, the more every

class member stands to recover. Moreover, because the major portion of the inflation is attributed to causes persisting throughout the period, interim corrective disclosures (of which there appear to have been only two or three) do not necessarily bring predisclosure purchasers into conflict with post-disclosure purchasers. Because both share an interest in maximizing overall inflation, the latter purchaser will no doubt strive to show a substantial market effect from disclosure of the lesser (or partial) causes of inflation to maximize the inflation attributable to more serious causes persisting when he bought—a showing which will increase the recovery of the earlier purchaser. In that light, any conflicting interests in tracing fluctuations in inflation during the class period are secondary, and do not bar class litigation to advance predominantly common interests. Courts faced with the same situation have repeatedly, either explicitly or implicitly, rejected defendants' position, for the potential conflict is present in most prolonged classes involving a series of misrepresentations. *See Green v. Wolf Corporation, supra; Tucker v. Arthur Andersen & Co.*, at 475-476 and 476 n. 14, and cases there cited, and at 97,936; *Aboudi v. Daroff, supra,* at 391-392; *U. S. Financial Securities Litigation, supra*, at 452; *In re Memorex Security Cases, supra; Caesars Palace Securities Litigation, supra; Siegel v. Realty Equities Corporation of New York, supra*, at 426; *Dolgow v. Anderson, supra; Fischer v. Kletz, supra*, at 381-383; *Kronenberg, supra.*

In support of that conclusion, we note that Rule 23 makes no mention of conflicts. The Rule's requirements are that the representative's claims be "typical" and that the class be "fairly and adequately" represented—claims need not be coextensive. *Caesars Palace Securities Litigation, supra*, at 397. Those requirements are in part constitutionally dictated, as due process requires, in order to give collateral res judicata effect to a judgment against class members, that their interests have been adequately

represented in the class action. *Hansberry v. Lee*, 311 U.S. 32, 61 S.Ct. 115, 85 L.Ed. 22 (1940).

Hansberry does not, however, as defendants seem to assume, dictate that any divergence of interest among class members violates due process (thereby necessarily requiring an identity of interests to satisfy Rule 23's adequacy or representation and typicality requirements). Neither the Rule's requirements nor those of due process are so inflexible. The due process touchstone of adequacy and fairness of representation (*see In re Four Seasons Securities Laws Litigation*, 502 F.2d 834, 842 (10th Cir. 1974); *Eisen IV*, at 177) must be judged in light of the seriousness and extent of conflicts involved compared to the importance of issues uniting the class; the alternatives to class representation available;[26] the procedures available to limit and prevent unfairness; and any other facts bearing on the fairness with which the absent class member is represented.

Hansberry is not controlling here—in *Hansberry* there was nothing to satisfy due process. Not only were the members of the purported class of property owners diametrically opposed on the central issue—the validity of racial covenants restricting their property—but the state class action procedure provided absent class members no notice. Here, on the other hand, under the notice and opt-out procedure of Rule 23(b)(3) and 23(c)(2),

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26. The rule requires adequate representation. The alternative may be none at all.

> "The basic concept of commonality, a requirement which is prevalent throughout Rule 23 and is premised upon a fundamental recognition that representatives of a class must have interests which are not in opposition to the members of that class, must be interpreted to best effectuate the primary purposes of the class action device, i. e., to give small investors a reasonable opportunity to vindicate their claims in a manner which will not place an undue burden upon them. It is in this light that we must approach the defendants' objections to the instant class actions under Rule 23(a)(3)." *Caesars Palace Securities Litigation, supra,* at 397-398.

an absent class member may evaluate his position in the class and decide for himself whether to avail himself of the representation offered. *See, e.g., Four Seasons Securities Laws Litigation, supra*, at 842-844; *Herbst v. Able, supra*, at 15. The potential conflicts are at most peripheral. And the district judge will retain constant supervision, through his powers under Rule 23(d) and (e), and through his ability to decertify or create sub-classes, to assure fairness of representation. *See Dolgow v. Anderson, supra*, at 496. Finally, and unlike numerous cases in which even one representative has been held adequate to represent a prolonged class, the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus will probably represent whatever conflicting interests there are in the development of plaintiffs' trial strategies. In light of those various factors, we agree with the district judge that the class representatives are typical and will adequately and fairly represent the class.[27]

Affirmed.

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27. We likewise reject the contention that conflicts between debenture holders and shareholders require decertification at this time; *see Handswerger v. Ginsberg, supra*, at 97, 240--97, 241; *Caesars Palace Securities Litigation, supra*, at 398--399; *Fischer v. Kletz, supra*, at 384; or that present shareholders and those purchasers who have sold their shares irreconcilably conflict. *See Handswerger, supra*, at 97, 240 n. 3; *Herbst v. ITT, supra*, at 1314; *Herbst v. Able, supra*, at 15.

JUDGMENT OF THE COURT OF APPEALS

United States Court of Appeals
For the Ninth Circuit

William E. Roberts, John P. Buchan, William Blackie, etc., et al.,
Defendants-Appellants,
v.
Leonard Barrack, Selma Molder, etc., et al.,
Plaintiffs-Appellees.

No. 74-2648
Civil 72-0521

APPEAL from the United States District Court for the NORTHERN District of CALIFORNIA

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the NORTHERN District of CALIFORNIA and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is AFFIRMED.

A True Copy Attest Feb 27 1976
Emil E. Melfi, Jr., Clerk
by Tim Jones, Deputy
Filed and entered September 25, 1975

ORDER OF THE COURT OF APPEALS DENYING PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING IN BANC

United States Court of Appeals
For the Ninth Circuit

FILED DEC 16, 1975
Emil E. Melfi, Jr.
Clerk, U.S. Court of Appeals

Leonard Barrack, et al., Plaintiffs-Appellees, vs. William Blackie, et al., Defendants-Appellants.	No. 74-2141
Benjamin L. Kushner, Plaintiff-Appellee, vs. Ampex Corporation, Defendant-Appellant.	No. 74-2167
Benjamin L. Kushner, et al., Plaintiffs-Appellees, vs. William E. Roberts and John Buchan, Defendants-Appellants.	No. 74-2341
Leonard Barrack, et al., Plaintiffs-Appellees, vs. Touche Ross & Co., Defendant-Appellant.	No. 74-2466
Leonard Barrack, et al., Plaintiffs-Appellees, vs. William E. Roberts, et al., Defendants-Appellants.	No. 74-2648

Before: Tuttle,* Koelsch and Browning, Circuit Judges.

*The Honorable Elbert P. Tuttle, Senior United States Circuit Judge for the Fifth Circuit, sitting by designation.

ORDER DENYING PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING IN BANC

The panel, as constituted in the above case, voted to deny the petition for a panel rehearing. Judges Koelsch and Browning voted to reject the suggestion for a rehearing in banc, and Judge Tuttle has recommended against an in banc rehearing.

The full court has been advised of the suggestion for an in banc hearing, and no judge of the court has requested a vote on the suggestion for rehearing in banc. F. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for a rehearing in banc is rejected.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

UNITED STATES CONSTITUTION, AMENDMENT V provides as follows:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934 (15 U.S.C. § 78j(b)) provides in relevant part as follows:

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

THE ENABLING ACT (28 U.S.C. § 2072) provides as follows:

Rules of civil procedure

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court.

RULE 10B-5 (17 C.F.R. § 240. 10b-5) provides as follows:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce,

or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

RULE 23 OF THE FEDERAL RULES OF CIVIL PROCEDURE provides as follows:

Class actions

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or

substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to Be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified

date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate

therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1258

WILLIAM BLACKIE, et al.,

Petitioners,

v.

LEONARD BARRACK, et al.,

Respondents.

Supplemental Brief of Petitioners Blackie, et al.

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In the Supreme Court of the United States

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Supplemental Brief of Petitioners Blackie, et al.

Petitioners respectfully submit this supplemental brief concerning the effect of the agreement for partial settlement which was entered into after their petition for certiorari was filed, and referred to in briefing before this Court by respondents in their opposition brief.

I. The Petitions Are Not Now Moot and May Never Become Moot by Reason of the Proposed Partial Settlement Agreement.

Respondents argue in their opposition (pp. 3-4) that the proposed partial settlement will render the petitions for certiorari moot on judicial approval of the proposed partial settlement. This statement is incomplete and fails to provide the Court with full and fair advice concerning the pertinent provisions of the agreement respecting the pending petitions for certiorari, as explicitly required by the agreement (Appendices A and B).

The agreement for the proposed partial settlement does not moot the petitions for certiorari because: (1) the proposed partial settlement might be disapproved by the District Court, in which case it would become null and void (Appendix C), (2) the proposed settlement can by its terms be terminated by the settling defendants if aggregate opt-out losses exceed a specified amount (Appendix D), and (3) the proposed setttlement agreement might also be terminated by plaintiffs depending upon the insurer's performance (Appendix E).

Therefore, questions on the petitions for certiorari concerning the propriety of the class may never become moot by reason of the proposed settlement agreement, and certainly are not moot now.

In view of the uncertainties of final approval of a consummated settlement as proposed, the agreement specifically provides in paragraph 3, set forth in Appendix A hereto, that if, prior to the effective date, which is the date of determination of, or expiration of time for, appeal from final approval of the proposed settlement by the District Court (Appendix B), the Supreme Court shall have acted on the petitions in any manner requiring revision or amendment of the proposed settlement, then such changes therein as are required, as approved by the District Court, shall be included in the settlement agreement, but that if, prior to the effective date, no such action requiring changes shall have been taken, the petitions will be dismissed.

These provisions were not only agreed to, but are essential to protect petitioners against the possibility of failure of the proposed settlement. If the petitions were dismissed as moot upon the mistaken assumption that petitioners had consented thereto, petitioners would be saddled with the burden of the erroneous decision of the Ninth Circuit in the event of failure of the settlement, and, in addition, with the problem whether a stipulated dismissal of the petitions for certiorari would be proper in order

to effect a settlement agreement entered into with class representatives whose authority to act for members of the class is the subject of the petitions.

In brief, the petitions are not in fact moot by reason of the proposed partial settlement, and any determination of the petitions on such ground would unjustly imperil the vital interests of petitioners.

II. The Partial Settlement Agreement Is Not, and Was Specifically Agreed Not to Be Used As, Any Admission or Concession on the Part of the Settling Defendants of Any Liability or Wrongdoing.

At page 28 of their brief in opposition, respondents refer to the provisions in the partial settlement agreement for payment of $7,750,000 and state: "The indication is that if defendants truly believed their proclaimed innocence, their appropriate remedy would be to move for summary judgment."

The partial settlement agreement provides:

> "2. *Disclaimers.* This settlement and any proceedings taken hereunder shall not in any event be construed as or deemed to be evidence or an admission or concession on the part of the settling defendants or any of them, of any liability or wrongdoing whatsoever, or on the part of the plaintiffs of any lack of merit in their actions. This Settlement Agreement and each of its provisions shall not be offered or received in evidence in these Consolidated Class Actions or any other action or proceeding as an admission or concession of liability or wrongdoing of any nature on the part of the settling defendants or any of them or as any admission or concession on the part of plaintiffs. The settling defendants specifically disclaim and deny any liability or wrongdoing whatsoever with respect to all the allegations contained in the complaints in these Consolidated Class Actions, including without limitation, those relating to alleged violations of the Securities Exchange Act of 1934."

In brief, the partial settlement agreement is *not* evidence of defendants' lack of innocence. On the contrary, the partial settlement agreement was entered into by the settling defendants in the best interests of Ampex to avoid the consequences to Ampex of the erroneous decision of the Ninth Circuit Court of Appeals which we seek to have reviewed. Those consequences could be disastrous to Ampex quite apart from the merits of plaintiffs' claims, for the reasons stated in our petition for certiorari.

We therefore respectfully pray the Court *not* to determine the petitions for certiorari on the ground that they are moot by reason of the proposed partial settlement, which they are definitely not.

Dated: June 17, 1976.

Respectfully submitted,

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(Appendices follow)

Appendix A

"3. *Petitions for a Writ of Certiorari.*

"(a) The settling defendants have filed in the United States Supreme Court two separate Petitions for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, and the nonsettling defendant has also filed a Petition for a Writ of Certiorari. If and when the effective date hereof shall have occurred, this Settlement Agreement shall be binding between the parties hereto according to its terms, which shall include any revisions or amendments hereto, as approved by the District Court, which are necessitated by any action, if any, by the Supreme Court with respect to said petitions for certiorari theretofore taken. If prior to the effective date hereof, the Supreme Court shall not have granted any of said petitions, reversed, remanded or otherwise taken any action with respect thereto, other than dismissing them or merely postponing them for consideration, which might affect the status of the decision of the Ninth Circuit Court of Appeals herein as the law of the case, the petitions for certiorari of settling defendants will be dismissed.

"(b) The parties to this Settlement Agreement understand that counsel for plaintiffs may wish to seek extensions of time within which plaintiffs must file a response to the aforesaid petitions, and settling defendants will not oppose such extensions. It is agreed that no representation will be made to the Supreme Court that there has been a settlement agreement with the settling defendants unless the agreement has been executed by the settling parties in final form and that any such representation shall advise the Supreme Court fully and fairly of the provisions in the settlement concerning the petitions for certiorari."

Appendix B

"1. *Definitions.* As used herein, the following terms shall have the following meanings:

* * *

"(1) 'Effective date' means: (a) thirty-one days after the entry of the judgment as provided for below in paragraph 11 approving this Settlement Agreement and dismissing with prejudice and on the merits the actions against settling defendants brought by the plaintiffs (as defined in paragraph 1(n) hereof), if the judgment be final on that date, or (b) if appeal time shall be extended or if appeal be taken, the date when such judgment is final and upon which it is no longer subject to judicial review."

Appendix C

"12. *Disapproval of the Settlement.*

"(a) If the Court does not approve this settlement after the hearing . . ., this Settlement Agreement and all other agreements, papers, and documents relating thereto and all orders entered in connection therewith shall . . . thereupon become null and void in all respects without further act by any party hereto. . . ."

Appendix D

"8. *Election To Be Excluded From the Class*

• • •

"(b) If persons electing to be excluded from the class who have aggregate or individual Gross Losses (as calculated in accordance with the provisions of subparagraph 8(c) below and determined from the information set forth in or obtained in connection with requests for exclusion), which losses in dollar

amount exceed amounts separately stipulated among counsel for the parties hereto, then this Settlement Agreement may be cancelled and terminated at the option of the undersigned defendants in accordance with a separate agreement among them and by telephone notice and letter by McCutchen, Doyle, Brown & Enersen to the Court and all signatories hereto, provided that such telephone notice shall be given not later than seventy-two (72) hours preceding the date finally set, by adjournment or otherwise, for the hearing on the settlement, as referred to in subparagraph 9(a)(2) below. The amounts referred to in this subparagraph shall be set forth in said separate agreement, which shall be sealed and filed with the Court together with this Settlement Agreement. Upon giving such notice to all parties hereto and the Court, this Settlement Agreement and all orders entered in connection therewith shall, subject to subparagraph 12(b) below, become null and void in all respects without further act by any party hereto."

Appendix E

"5. *Settlement Fund.* In full and final settlement and discharge of all claims, which have been or might be asserted arising out of or relating to the matters set forth in the complaints herein, including any possible derivative claims, against each of the settling defendants, their predecessors, successors, personal representatives, heirs, assigns and present or former officers, directors, employees and attorneys or other Ampex agents (expressly excluding defendant Touche Ross & Co. and its present and former partners, principals, employees and agents), the settling defendants, within 20 days of the execution of this agreement, shall deposit $125,000 in cash in a special account with The Philadelphia National Bank in the names of David Berger, P.A., lead counsel for plaintiffs, and McCutchen, Doyle, Brown & Enersen, lead counsel for settling defendants, and shall furnish to said

lead counsel for plaintiffs evidence of one or more irrevocable letters of credit, payment bonds or acceptable equivalent thereof in the aggregate amount of $2,125,000 to secure the payment of the further deposit of $2,125,000 as provided below and an assignment without recourse by Ampex of an unsecured agreement of Lloyd's of London to pay Ampex $5,500,000 within 10 days after the effective date hereof. Within 10 days after the effective date hereof, the settling defendants shall deposit $2,125,000 in said special account; and Ampex as assignor and said lead counsel for plaintiffs as assignee shall demand that Lloyd's of London pay said unsecured obligation of $5,500,000 by depositing said sum in said special account. None of the settling defendants guarantees the unsecured agreement of Lloyd's of London to pay $5,500,000 within 10 days after the effective date hereof, but if said sum is not paid within 10 days after the effective date hereof, then plaintiffs' lead counsel at their option may elect to terminate this agreement by giving written notice of such election to the court and all signatories hereto . . ."

IN THE

Supreme Court of the United States

October Term 1976

No.

No. 75-1258

WILLIAM BLACKIE, *et al.*,

Petitioners,

vs.

LEONARD BARRACK, *et al.*,

Respondents.

No. 75-1300

TOUCHE ROSS & CO.,

Petitioner,

vs.

LEONARD BARRACK, *et. al.*,

Respondents.

No. 75-1314

WILLIAM E. ROBERTS and JOHN P. BUCHAN,

Petitioners,

vs.

LEONARD BARRACK, *et al.*,

Respondents.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Respondents.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

This brief is submitted in opposition to three related petitions for writs of certiorari, which seek review of a

judgment and decision of the United States Court of Appeals for the Ninth Circuit, entered in these proceedings on September 25, 1975.

That decision dismissed the appeal of petitioner Touche Ross & Co. ("Touche Ross"), taken pursuant to 28 U.S.C. § 1291,[1] from an interlocutory class action certification order entered by the United States District Court for the Northern District of California. Dismissal of the appeal was required by the final judgment rule applied in accordance with well settled principles established by this Court and consistently followed by all the Circuit Courts. This Court has declined to review such principles on three recent occasions. *Touche Ross & Co.* v. *Fabrikant*, 96 S.Ct. 424 (1975); *Touche Ross & Co.* v. *Seiffer*, 96 S.Ct. 779 (1976); *Cessna Aircraft Co.* v. *White*, 96 S.Ct. 363 (1975). This petition raises no new reasons for review or for departure from the final judgment rule not present in those prior petitions.

The decision dismissing Touche Ross' § 1291 appeal also unanimously affirmed the class certification order, on appeals taken pursuant to 28 U.S.C. § 1292(b)[2] by the petitioners other than Touche Ross. Certiorari to review such affirmance should be declined in the absence of any showing of abuse of the District Court's exercise of discretion.

Questions Presented

(a) With Respect to Petitioner Touche Ross

Does an appeal lie under 28 U.S.C. § 1291 challenging the propriety of a trial judge's exercise of discretion in

[1] All statutory references are set forth in the Appendix. 28 U.S.C. § 1291 is at Appendix A-1.

[2] 28 U.S.C. § 1292(b) is set forth at Appendix A-1.

issuing an interlocutory order which found that the requirements of F.R.Civ.P. Rule 23(b)(3)[3] had been met where: the order is not separable from the merits; appellant has not demonstrated irreparable harm; the order will not materially alter the manner in which the action will proceed; and the order can be fully and effectively reviewed after final judgment?

With respect to petitioner Touche Ross, no controversy arises from that portion of the Circuit Court's opinion which, pursuant to 28 U.S.C. § 1292(b), reviewed and unanimously affirmed the District Court's finding that the requirements of F.R.Civ.P. Rule 23(b)(3) had been met. Touche Ross neither requested nor was granted certification pursuant to § 1292(b), and the Circuit Court expressly refused § 1292(b) review as to Touche Ross. Its appeal was dismissed solely upon the basis of 28 U.S.C. § 1291. Touche Ross does not contest the Circuit Court's exercise of discretion to deny § 1292(b) certification.

(b) With Respect to All Other Petitioners

All petitioners other than Touche Ross have agreed to pay $7.75 million in cash to the class represented by respondents, in partial settlement of this action, and have agreed to withdraw their petitions for certiorari when such partial settlement has been judicially approved as required by F.R.Civ.P. Rule 23(e)[4] and becomes effective. On June 3, 1976, the District Court signed an order setting a date in late August 1976 for a hearing as to the fairness and adequacy of the settlement.

Judicial approval of the partial settlement will render moot the issue raised by all petitioners other than Touche

[3] The relevant provisions of F.R.Civ.P. Rule 23 are set forth at Appendix A-1.

[4] The provisions of F.R.Civ.P. Rule 23(e) are set forth in Appendix A-3.

Ross. That issue is whether the Circuit Court correctly affirmed, pursuant to 28 U.S.C. § 1292, the District Court's class certification order (1) where no abuse of discretion was shown in the District Court's finding that the requirements of F.R.Civ.P. Rule 23(a) and (b) were satisfied, and (2) where the legal principles applied were consistent with this Court's decisions and have been uniformly followed by the district and circuit courts in all the Circuits of this country, in regularly granting class status in security fraud actions substantially similar to this one.

STATEMENT OF THE CASE

This litigation[5] was precipitated by Ampex's unexpected announcement in January 1972 of anticipated losses of $40 million for the fiscal year ended April 30, 1972. In August 1972, Ampex announced a loss of $89.6 million, out of a net worth of approximately $135 million. Touche Ross, who was Ampex's auditor, then withdrew its earlier published certification of Ampex's financial statements for the year ended April 30, 1971. Touche Ross also declined to certify Ampex's financial statements for the year ended April 30, 1972 because of stated fears that a material part of the $89.6 million loss reported for 1972 was in fact incurred in 1971 or earlier.

The amended complaint alleges that the defendants fraudulently induced plaintiffs and other members of the

[5] This action was brought under Sections 10(b) and 13(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78m(a), and Rules 10b-5, 3a-3 and 13a-13 promulgated by the Securities and Exchange Commission pursuant to those sections. Plaintiffs have sued on behalf of the class of all persons who purchased securities of Ampex from May 2, 1970 to August 3, 1972. Defendants are Ampex, its officers and directors during the period and Touche Ross & Company, independent auditors for Ampex during the period. All of such parties are petitioners herein. The text of Section 10(b) and Rule 10b-5 are set forth in the Appendix, at A-3 and A-4.

class to purchase Ampex securities at excessive prices by the issuance of annual and interim reports and other documents which failed to disclose the material facts leading to the subsequent huge write-offs. The named plaintiffs and intervenors purchased 10,000 shares of Ampex stock at a cost of over $149,000 during the class period certified by the District Court. The purchases were made at inflated prices and resulted in a loss to plaintiffs and intervenors in excess of $70,000.00.

The papers before the Circuit Court showed that there are only nine key documents alleged to be false and misleading. Those documents are Ampex's annual reports for 1970 and 1971, and its interim reports for 1970 and 1971. The other documents described in the complaint are for the most part reiterations of information contained in the annual and interim reports.

The complaint alleges that these nine documents—all of which were disseminated in written form to the public—omitted material facts with respect to, and misrepresented the valuation of, inventories, research and development costs, reserves for doubtful accounts and notes receivable and royalty payment liabilities, and the impact resulting from discontinuance of certain product lines. The misrepresentations and omissions were designed to and did cumulatively and substantially inflate reported income or reduce reported losses throughout the period.

REASONS FOR DENYING THE WRIT

Summary of Argument

Touche Ross' petition should be denied because the interlocutory class order from which it appealed under § 1291 was not a final order, and would not have been

appealable as an exception to the final judgment rule in any Circuit. There is no difference in opinion among the Circuits on that question, and accordingly, there is no controversy for this Court to now consider with respect to Touche Ross. Because Touche Ross neither requested nor was granted certification pursuant to 28 U.S.C. § 1292(b), it may not petition from the merits of the Circuit Court's affirmance of the class certification order.

With respect to the other petitioners, whose appeals were heard pursuant to 28 U.S.C. § 1292(b), the Circuit Court's affirmance of the interlocutory class certification order was not only proper, but was mandatory in the complete absence of any showing that the trial court abused its discretion in certifying the class.

It will be demonstrated that the Circuit Court's decision did not break new ground in its application of F.R.Civ.P. Rule 23 to claims arising under § 10(b) and Rule 10b-5. There are clear common issues of fact and law running throughout the period, of the same sort which the federal courts have regularly found more than sufficient to justify class treatment. The Circuit Court's opinion followed long established decisional law in finding that the reliance issues raised by petitioner did not outweigh the predominant common issues so as to affect class status, and in its decision that any conflicts involved were peripheral and of the sort found in every securities class action. Its decision that class treatment is superior to alternate treatment recognizes that in cases of this sort, a class remedy is the only effective remedy for large scale fraud injuring thousands of investors through written matter disseminated to the public.

In following the mainstream of decisional law that § 10(b) liability as regularly interpreted by the courts is amenable to class treatment, the Circuit Court adhered to

repeated statements by this Court that federal securities legislation and § 10(b) in particular should be construed not technically and restrictively, but flexibly to effectuate the congressional purposes. The Circuit Court acted in a manner consistent with the statement in *Blue Chip Stamp Co.* v. *Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917 (1975), that the court was not abandoning the investing public who were victims of fraud. (*Blue Chip,* concurring opinion fn. 5). In addition, the Circuit Court's opinion carefully followed the instructions of *Blue Chip* and *Ernst & Ernst* v. *Hochfelder,* — U.S. —, 96 S.Ct. 1375 (1976), to follow established decisional law so as not to enlarge the class of persons protected by the federal securities laws beyond those whom Congress intended to protect.

1. With Respect to Touche Ross there is No Controversy for This Court to Now Consider Because the Instant Class Order Would Not be Appealable Under § 1291 as a Final Order in any Circuit.

The Circuit Court's opinion makes it clear that Touche Ross' appeal was required to be dismissed pursuant to 28 U.S.C. § 1291 under the standards established by this Court and applied by all of the Circuit Courts of Appeal (see footnote 8 of opinion).

In an attempt to manufacture a controversy ripe for consideration by this Tribunal, Touche Ross suggests that there may be a conflict among the Circuits on the § 1291 appealability of class orders. No such conflict exists. More important, such a conflict would be moot in this case, because the Circuit Court expressly considered the standards of appealability followed by all the Circuits, and found that petitioner's appeal would not be permitted anywhere.

The crucial importance of the final judgment rule, 28 U.S.C. § 1291, to the efficient and just administration of the

Federal judicial system, *Cobbledick* v. *United States,* 309 U.S. 323 (1940), permits a departure from that rule only in a narrow category of cases where the non-final order appealed (1) is separable from and collateral to the claims asserted in the action, (2) would finally determine the collateral question, and (3) would result in irreparable harm by any delay in appeal. *Cohen* v. *Beneficial Indus. Loan Corp.,* 337 U.S. 541 (1949); *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974).

With only one exception, later overruled[6], the Circuit Courts have unanimously held that an appeal from an order certifying a class does not fit within the *Cohen* collateral order doctrine, described *supra,* and would be contrary to the final judgment rule. *In Re U.S. Financial Securities Litigation,* — F.2d — (9th Cir. 1975), *cert. denied,* 96 S.Ct. 424 (1975); *White Industries, Inc.* v. *Cessna Aircraft Co.,* 518 F.2d 213 (8th Cir. 1975), *cert. denied,* 96 S.Ct. 363 (1975); *Seiffer* v. *Topsy's International, Inc.,* 520 F.2d 795 (10th Cir. 1975), *cert. denied,* 96 S.Ct. 779 (1976); *Kramer* v. *Scientific Control Corp.,* — F.2d — (3d Cir. April 20, 1976); *Handwerger* v. *Ginsberg,* 519 F.2d 1339 (2d Cir. 1975); *Parkinson* v. *April Industries, Inc.,* 520 F.2d 650 (2d Cir. 1975); *General Motors Corp.* v. *City of New York,* 501 F.2d 639 (2d Cir. 1974); *Walsh* v. *City of Detroit,* 412 F.2d 226, 227 (6th Cir. 1969); *Thill Securities Corp.* v. *New York Stock Exchange,* 469 F.2d 14 (7th Cir. 1972).

[6] The overruling of *Herbst* v. *International Telephone & Telegraph Co.,* 495 F.2d 1308 (2d Cir. 1974), is discussed *infra. Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974), is no exception. The Circuit Courts there had accepted jurisdiction on the basis of jurisdiction retained from a prior appeal. 479 F.2d 1005 (2d Cir. 1973). This Court considered there only questions relating to the imposition of costs of notice and the manner of giving notice, because those were the only collateral issues which fell within the *Cohen* collateral order doctrine. No such collateral issues are found here.

Those decisions have uniformly held that a discretionary order pursuant to F.R.Civ.P. 23(b)(3) is not separable from or collateral to the merits, because of the required findings with respect to the existence and predominance of common questions, the typicality of plaintiff's claim, and the like.[7]

Herbst v. *International Telephone & Telegraph Co.,* 495 F.2d 1308 (2d Cir. 1974), has been the only case allowing a § 1291 appeal from an order certifying a class. It held that a class order may be appealable when: (1) the class determination is "fundamental to the further conduct of the case", (2) the order is "separate from the merits", and (3) it will result in "irreparable harm to the defendant in terms of time and money spent in defending a huge class action." 495 F.2d at 1312.

Two of the three judges concurring in the decision issued separate opinions expressing "grave doubts" and "persistent perturbations" as to the propriety of accepting a § 1291 appeal from an order certifying a class action, and concurred primarily because *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974) (*Eisen* IV), was then pending before this Court.[8]

Approximately a month after the briefing was complete and oral argument took place on petitioner's appeal to the Circuit Court herein, the Court of Appeals for the Second Circuit in effect overruled *Herbst.* In *Parkinson* v. *April Industries, Inc., supra,* the Court noted that an appeal on the same facts as *Herbst* would no longer be permitted, 520 F.2d at 658, fn. 9, and affirmed the general non-

[7] Petitioners attack the Circuit Court's findings in these areas. (Touche Ross brief, pp. 6, 10-13, 17-18).

[8] This Court's subsequent decision in *Eisen* IV reaffirmed the exceptional circumstances required in order to invoke the *Cohen* collateral order doctrine.

appealability under § 1291 of orders such as that involved here, stating:

> "Our court in *General Motors* recognized that an appellant would not be able to satisfy the three-pronged test for an immediate interlocutory appeal if he only questioned the propriety of the discretionary ruling of a trial judge that the requirements of Rule 23(b)(3) had been met." 520 F.2d at 658.

Without benefit of the *Parkinson* clarification of the Second Circuit's position, the Circuit Court's decision herein considered the *Herbst* three-prong test. Rejecting it, just as *Parkinson* did, the Court nonetheless found that even under that test, a § 1291 appeal probably would not lie. The decision noted (footnote 8) that the first criteria, that the class determination be "fundamental to the further conduct of the case", may not be satisfied because "including intervenors, the named plaintiffs purchased 10,000 shares during the class period and damages would appear to be such that the action would proceed were the order reversed". In addition, the Circuit Court noted that "in this case, the second criteria [that the order be "separable from the merits"] is probably not met either", citing two Second Circuit decisions, *Kohn* v. *Royall Koegel & Wells,* 496 F.2d 1094 (2d Cir. 1974), and *General Motors* v. *City of New York,* 501 F.2d 639 (2d Cir. 1974).

That a § 1291 appeal would not lie in the only Circuit ever to accept such an appeal demonstrates that Touche Ross' claim of conflict among the Circuits is contrived merely to give the appearance of a controversy. But there is no controversy. Petitioner's position is moot, for its appeal would not have been accepted by any of the Circuit Courts of Appeal. Accordingly, there is nothing for this Court to review with respect to the dismissal of Touche Ross' § 1291 appeal.

2. The § 1292 Affirmance as to the Other Petitioners Was Required in the Absence of a Showing that the District Court Abused its Discretion in Certifying a Class.

It is well settled, and requires no review by this Court, that determination of a class action motion will not be disturbed on appeal in the absence of a showing that the trial court abused its discretion.

> "As was stated in *City of New York* v. *International Pipe & Ceramics Corp.,* 410 F.2d 295, 298 (2d Cir. 1969) 'the judgment of the trial court should be given the greatest respect and the broadest discretion, particularly if . . . he has canvassed the factual aspects of the litigation.' This is so because the district court is in the best position to consider the most fair and efficient procedure for conducting any given litigation. Such a determination by the court will not be disturbed unless the party challenging it can show an abuse of discretion." *Price* v. *Lucky Stores, Inc.,* 501 F.2d 1177, 1179 (9th Cir. 1974).

Accord, *City of New York* v. *International Pipe and Ceramics Corp.,* 410 F.2d 295 (2d Cir. 1969); *Clark* v. *Watchie,* 513 F.2d 994, 1000 (9th Cir.), *cert. denied,* 96 S.Ct. 72 (1975); *Wilcox* v. *Commerce Bank of Kansas City,* 474 F.2d 336 (10th Cir. 1973); *Castro* v. *Beecher,* 459 F.2d (1st Cir. 1972); *Harris* v. *Palm Springs Alpine Estates, Inc.,* 329 F.2d 909 (9th Cir. 1964); *Rutledge* v. *Electric Hose & Rubber Co.,* 511 F.2d 668 (9th Cir. 1975); *Appleton Electric Co.* v. *Advance-United Expressways,* 494 F.2d 126, 139 (7th Cir. 1974); *Wetzel* v. *Liberty Mutual Ins. Co.,* 508 F.2d 239 (3d Cir.), *cert. denied,* 421 U.S. 1011 (1975); *Hackett* v. *General Host Corp.,* 455 F.2d 618 (3d Cir. 1972), *cert. denied,* 407 U.S. 925.

The above cited decisions recognize that any determination of the predominance of common questions and superiority of class action, as well as of the adequacy of representation is intertwined with the specific facts of a case, and that the District Court alone is in the position to continuously reassess its initial decision on a developing record. It is for that reason that the Circuit Courts have been loathe to interfere with class approval, particularly on interlocutory review. *E.g., Thill Securities Corp.* v. *New York Stock Exchange, supra,* at 17.

The petitioners did not sustain their burden of showing any abuse of the trial court's exercise of discretion in determining the class motion. That determination was made after extensive briefing and argument. As the Circuit Court decision noted, the trial court analyzed the allegations of the complaint and other material sufficient to form a reasonable judgment on each of the requirements of F.R.Civ.P. Rule 23, and considered the nature and range of proof necessary to establish these allegations, before determining that the requirements were met. In addition, as demonstrated below, the trial court properly applied the criteria of Rule 23 by utilizing established principles of law which have been uniformly followed by the courts in all Circuits since the inception of F.R.Civ.P. Rule 23, in granting class status in cases substantially similar to this one.

3. The District Court and the Circuit Court Properly Applied Established Legal Criteria In Determining That the Requirements of F.R.Civ.P. Rule 23 Were Met.

Defendants' primary attacks upon the propriety of class certification are: (1) that the case did not present common questions of fact and law; (2) that direct individual proof of subjective reliance was required by each class member in order to establish 10b-5 liability, so that predominant

individual issues overshadowed the common questions of law and fact which are inherent in the case; and (3) that proof of liability or damages might create conflicts among class members and with the named plaintiffs sufficient to make representation inadequate. Both the District Court and the Circuit Court rejected these contentions. In doing so, they followed long established legal principles adhered to virtually uniformly by almost all the District Courts in granting class status on facts substantially similar to those here despite objections identical to those raised by petitioners herein. The uniformity of such decisions argue for denial of review by this Court. *Blue Chip Stamp Co.* v. *Manor Drug Stores, supra,* at 95 S.Ct. 1923, 1924.

(a) *Common Questions of Law and Fact Were Properly Found to Exist.*

The allegations of the complaint and the facts before both the District and Circuit Courts demonstrated clearly that common questions existed throughout the entire class period. The Circuit Court noted (opinion, fn. 19) that because plaintiffs alleged at least three specific strands of omission or misrepresentation running throughout the financial statements of the class period, the action was well within the boundaries of commonality delineated by the Courts, and no extension of previously set limits was required. The specific strands to which the Court referred are the failure to create adequate reserves for uncollectible accounts receivable and contractually guaranteed royalty payments, and the overstatement of inventory. Ampex's 1972 annual report showed write-downs of $31.9 million as provision for royalty guarantees, $11.8 million for uncollectible accounts receivables and $15 million for inventory. The complaint alleges and discovery to date demonstrates that these adjustments trace back to undisclosed problems in the beginning of the class period. This is supported by Touche

Ross' withdrawal of its certification of the 1971 report because of uncertainty as to whether the huge losses reported in 1972 were attributable to earlier years. The failure to establish appropriate reserves for uncollectible accounts and for royalty guarantees and the overstatement of inventory all served to artificially inflate Ampex's earnings and net assets throughout the period. This inflation is common to every purchaser and damaged every purchaser in the same manner. The Circuit Court properly noted that the artificial inflation persisted throughout the entire class period, ceasing only when the appropriate reserves were established and disclosed in the 1972 Annual Report.

Both the District Court and the Circuit Court correctly found that the consistent disregard of accounting principles underlying these matters raised common questions of law and fact with respect to the entire class for the whole class period. The Circuit Court also found that even if one assumed the reserves to be inadequate and the inventory overvalued by varying amounts throughout the class period, there still would remain common questions of law and fact with respect to the proper application of the accounting principles used to establish such reserves.

In so finding, the Circuit Court followed the overwhelming weight of authority, which holds that repeated misrepresentations of the sort alleged here satisfy the "common question" requirement of F.R.Civ.P. Rule 23 and that minor differences in the position of various class members do not affect this commonality. *Green* v. *Wolf Corporation*, 460 F.2d 291, 298 (2d Cir. 1968); *Esplin* v. *Hirschi*, 402 F.2d 94 (10th Cir. 1968); *Harris* v. *Palm Springs Alpine Estates, supra*; *In re U.S. Financial Securities Litigation*, 64 F.R.D. 443 (S.D.Cal. 1974) *app. dismissed* — F.2d —

(9th Cir. 1975), *cert. denied*, 96 S.Ct. 424 (1975); *Aboudi* v. *Daroff*, 65 F.R.D. 388 (S.D.N.Y. 1974); *Werfel* v. *Kramarsky*, 61 F.R.D. 674 (S.D.N.Y. 1974); *In re Memorex Security Cases*, 61 F.R.D. 88 (N.D.Cal. 1973); *Siegel* v. *Realty Equities Corporation of New York*, 54 F.R.D. 420 (S.D.N.Y. 1972); *Herbst* v. *Able*, 47 F.R.D. 11 (S.D.N.Y. 1969); *Dolgow* v. *Anderson*, 43 F.R.D. 472 (E.D.N.Y. 1968); *Siegel* v. *Chicken Delight, Inc.*, 271 F.Supp. 722 (N.D.Cal. 1967); *Fischer* v. *Kletz*, 41 F.R.D. 377, 381 (S.D.N.Y. 1966); *Kronenberg* v. *Hotel Governor Clinton, Inc.*, 41 F.R.D. 42 (S.D.N.Y. 1966). This is consistent with the views of the Advisory Commission on the Rule: "fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action . . .". Advisory Committee on Rule 23, Proposed Amendments to the Rules of Civil Porcedure, 39 F.R.D. 69, 103 (1966).

The longstanding uniformity of opinion among the Circuit and District Courts on this question argues for its correctness, *Blue Chip Stamp Co.* v. *Manor Drug Co., supra*, and requires no review by this Court.

(b) *Courts Have Uniformly Rejected Contentions Which Would Permit Reliance or Damage Issues to Predominate Over Common Issues of Law and Fact.*

The arguments which petitioners raise as to the effect on predominance of reliance and damages have been rejected by virtually all courts to whom they have been presented. Even before standards of reliance were clarified by this and other courts—so that the possibility of individual proof of reliance existed—federal courts have not permitted that issue to bar class treatment, particularly where they had determined the existence of a "common nucleus" of facts such as are present in this case. *Green* v. *Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied sub nom., Troster, Singer & Co.* v. *Green*, 395 U.S. 977

(1969); *Herbst* v. *International Telephone and Telegraph Corporation,* 65 F.R.D. 13 (D.Conn. 1973), *aff'd,* 495 F.2d 1308 (2d Cir. 1974); *Korn* v. *Franchard Corporation,* 456 F.2d 1206, 1212-13 (2d Cir. 1972); *Epstein* v. *Weiss,* 50 F.R.D. 387 (E.D.La. 1970); *In re National Student Marketing Litigation,* CCH Fed.Sec.L.Rep. ¶ 94,165 (D.D.C. 1973); *In re Penn Central Securities Litigation,* 347 F.Supp. 1327 (E.D.Pa. 1972), *aff'd on other grounds,* 494 F.2d 528 (3d Cir. 1974); *Feder* v. *Harrington,* 52 F.R.D. 178, 183 (S.D. N.Y. 1970); *Mersay* v. *First Republic Corp. of America,* 43 F.R.D. 465 (S.D.N.Y. 1968); *Weiss* v. *Tenney Corporation,* 47 F.R.D. 283 (S.D.N.Y. 1969); *Fogel* v. *Wolfgang,* 47 F.R.D. 213 (S.D.N.Y. 1969); Frankel, *Some Preliminary Observations Concerning Civil Rule 23,* 43 F.R.D. 39 (1967); Comment, Reliance Upon Rule 10b-5: Is The "Reasonable Investor" Reasonable? 72 *Colum. L. Rev.* 562, 577-79 (1972).

The reason for this long accepted rule was stated in *Dolgow* v. *Anderson,* 43 F.R.D. 472 (E.D.N.Y. 1968), as follows:

> "In spite of this abundance of common questions, defendants argue that each member of the class would have to prove reliance, compliance with the statute of limitations, and damages, and thus the common questions cannot be said to predominate over those affecting individual members. To 'acknowledge defendants' position at this point would be, in effect, an emasculation of the vitality and pliability of the amended rule.' Siegel v. Chicken Delight, Inc., 271 F.Supp. 722, 727 (N.D. Cal. 1967). The common issues need not be dispositive of the entire litigation. The fact that questions peculiar to each individual member of the class may remain after the common questions have been resolved does not dictate the conclusion that a class action is not permissible.

> "In fact, in the present case, these individual questions present 'no difficulty not inherent in every securities class action.' Kronenberg v. Hotel Governor Clinton, Inc., 41 F.R.D. 42, 45 (S.D.N.Y. 1966). See, e.g., Harris v. Palm Springs Alpine Estates, Inc., 329 F.2d 909, 914 (9th Cir. 1964); Fischer v. Kletz, 41 F.R.D. 377 (S.D.N.Y. 1966); Brennan v. Midwestern United Life Ins. Co., 259 F.Supp. 673 (N.D. Ind. 1966)." 43 F.R.D. at 490.

Accord: *Herbst* v. *International Telephone and Telegraph* Corporation, 65 F.R.D. 13, 18-19 (D.Conn. 1973), *aff'd,* 495 F.2d 1308 (2d Cir. 1974).

It is certain that any other view would cripple F.R.Civ.P. Rule 23 in precisely those situations where the Advisory Committee believed it most useful, such as where a large number of investors have been defrauded in the same manner by the same or similar written statements.

Plainly then, even if petitioners were correct that reliance were individually at issue, the critical common questions of law and fact associated with the proof of omissions and misrepresentations would predominate. Petitioners' long exposition on reliance is therefore extraneous to the class determination.

In any event, both the District Court and the Circuit Court followed established case law in rejecting petitioners' contention that individualized proof of subjective reliance is required by each class member in order to establish a claim pursuant to Rule 10b-5.

This Court itself initiated the rule that individualized proof of subjective reliance is not required in an action in which omissions played a key role, because the obligation to disclose and failure to disclose establish the requisite element of causation in fact. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972); *Mills* v. *Electric Auto-Lite Co.,*

396 U.S. 375 (1970). Omissions with respect to the accounts receivable reserves, inventory overstatement and royalty reserves are at the heart of this case. The *Ute* rule is appropriate here also because Ampex's directors and auditors stood in a fiduciary relationship to its shareholders similar to that occupied by defendants in *Affiliated Ute Citizens.*

The Circuit Court held that individual proof of subjective reliance is not required because it imposes an unnecessarily difficult, irrelevant and redundant evidentiary burden, "addressed to a speculative possibility in an area where motivations are complex and difficult to determine". Such a burden would require "proof of a speculative negative (I would not have bought had I known) precisely parallel to that held unnecessary in *Affiliated Ute* and *Mills* . . .". That is the same sort of speculative proof that this Court discouraged in *Blue Chip Stamp Co., supra.* The Circuit Court found that "the [required] causal nexus can be adequately established indirectly [and objectively], by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock". That is particularly appropriate in open market purchases such as involved here, where all purchasers at inflated prices are damaged in the same manner, because the price paid reflects the material misrepresentations or omissions irrespective of whether the particular purchaser subjectively relied on a particular representation when purchasing.

The identical principle—that deception affecting the open market price of securities makes individualized proof of reliance unnecessary—was endorsed in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 374 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973):

> "Where the transaction is accomplished through impersonal dealings, such as on a stock exchange,

> or for some other reason the factors that influenced the parties are not readily apparent, the decisions have discussed liability in terms of the 'materiality' of the misrepresentation. See Heit v. Weitzen, 402 F.2d 909, 913 (2 Cir. 1968), cert. denied, 395 U.S. 903 (1969); List v. Fashion Park, Inc., supra, 340 F.2d at 462-64; Kahan v. Rosenstiel, 424 F.2d 161, 173-74 (3 Cir. 1970). This constructive reliance principle is particularly appropriate in class actions where proof of actual reliance by numerous class members would be impracticable. Kahan v. Rosenstiel, supra.
>
> "The [Supreme] Court [in *Mills*] established a presumption of reasonable reliance in order to avoid an overly difficult burden of proof. This was to encourage the vigorous enforcement of the securities laws through shareholder suits, and to effectuate the congressional purpose of enabling shareholders to make informed decisions 'by resolving doubts in favor of those the statute is designed to protect'. Id."

Accord: *Herbst* v. *International Telephone & Telegraph Co.*, 495 F.2d 1308, 1315 (2d Cir. 1974). Wrongful inflation of the open market price of Ampex securities is the gist of this action.

Decisions in other Circuits similarly have seen no need for individual proof of subjective reliance. *Woolf* v. *S.D. Cohn & Co.*, 515 F.2d 591, 614 (5th Cir. 1975), *rehearing and rehearing en banc denied*, 521 F.2d 225 (1975) (plaintiffs "must show that the omissions or misrepresenta-

tions . . . were such that a reasonable investor, had the information registration would have afforded been available, might have considered them important in the making of his investment decision. They need not show that they themselves would have relied . . .''); *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 288-91 (3d Cir. 1972), *cert. denied*, 409 U.S. 874 (1973); *Kahan* v. *Rosenstiel*, 424 F.2d 161 (3d Cir. 1970), *cert. denied*, 398 U.S. 950; *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974); *Competitive Associates, Inc.* v. *Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 814 (2d Cir. 1975); *In re Penn Central Securities Litigation, supra; Taylor* v. *Smith Barney & Co.*, 358 F.Supp. 829 (D. Utah 1973); *Davis* v. *Avco Corp.*, 371 F.Supp. 782, 792 (N.D. Ohio 1974); *Seiffer* v. *Topsy's International, Inc.*, 64 F.R.D. 714, 718 (D.Kans. 1974), *app. dism.*, 520 F.2d 795 (10th Cir. 1975), *cert. denied*, 96 S.Ct. 779 (1976); *Fischer* v. *Wolfinbarger*, 55 F.R.D. 129, 132 (W.D.Ky. 1971); *Livesay* v. *Punta Gorda Isles, Inc.*, 379 F.Supp 386, 387 (E.D.Mo. 1974).

The principle that individual proof of subjective reliance is not required in 10b-5 actions where omissions play a material role, or where the open market price of publicly traded securities was artificially inflated, or where a deliberate scheme to defraud is shown is consistent with the language of § 10(b) and with Rule 10b-5, neither of which provide that reliance is a requisite to recovery. The early decisions which judicially engrafted the notion of reliance into the statute and rule did so to insure a causal nexus between the alleged wrong and damage to the claimant. Evidence of the same causal relationship is more easily and objectively obtained by proof of materiality of misrepresentations or omission and resultant inflation in the price of the security purchased. This eliminates the sort of speculative subjec-

tive and non-certain proof which was one of the targets in this Court's decision in *Blue Chip, supra.*

The Circuit Court's view on reliance did not alter the substantive law of Section 10(b) but was merely an evidentiary rule allowing the causal nexus between the fraud and the loss of investors to be proved in a more efficient manner. The Circuit Court was clear that its evidentiary rule with respect to causation would be applied to private as well as class actions, and was independent of Rule 23 so that the Enabling Act does not come into play.

Moreover, the Circuit Court found that any right to attempt to disprove such causation would not render this action unmanageable. The Court merely cautioned that utilization of such right for purposes of delay and harassment might be limited by the trial court. The trial court traditionally has had the power to control the trial of the cases before it so as to exclude repetitive evidence and similar delaying tactics. (Opinion, fn. 22). The Federal Rules of Evidence, Rule 403 [9], explicitly give such power to the trial judge. The Circuit Court's cautionary statement raises no present controversy requiring review by this Court. Defendants have not yet demonstrated an intention to delay the trial of the causation issue herein by fruitless fishing expeditions, introduction of repetitive evidence or any of the other tactics against which the Circuit Court warned, nor has the trial court yet had to rule on the problem. If petitioners do not attempt to obstruct the trial in such a manner, resolution of this issue will not be required in this case. Accordingly, consideration of the issue is premature at this time.

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[9] Rule 403 provides that: "although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."

(c) *Courts Have Regularly Rejected Contentions That Proof of Liability or Proof of Damages in Actions Such as This Will Create Conflicts Among Class Members or with Named Plaintiffs.*

The District Court and Circuit Court rejected petitioners' contentions that the interest of class members in proving damages from price inflation and in proving the materiality of misrepresentations causing said inflation are in conflict, and thus constitute grounds for refusing to certify the class. Petitioners argued that some class members will desire to maximize inflation existing on a given date while others will desire to minimize it. Courts faced with the same contentions have repeatedly rejected that position, for that potential conflict is present in all class actions involving a series of misrepresentations over a prolonged period. *Green* v. *Wolf Corporation, supra; Tucker* v. *Arthur Andersen & Co.,* CCH Securities Law Rep. ¶ 95,107 at 97,931-97,932 and 97,932 n. 14, and cases there cited, and at 97,936 (S.D.N.Y. 1975); *Aboudi* v. *Daroff, supra; In re U.S. Financial Secuirties Litigation,* 64 F.R.D. 433 (S.D.Cal. 1974); *Grad* v. *Memorex,* 61 F.R.D. 88 (N.D. Cal. 1973); *In re Caesar's Palace Securities Litigation,* 360 F.Supp. 366 (S.D.N.Y. 1973); *Siegel* v. *Realty Equities Corporation of New York, supra; Dolgow* v. *Anderson, supra; Fischer* v. *Kletz, supra.*

The aforementioned cases show that even if a potential conflict exists, such conflict is not sufficient reason to deny class status, because Rule 23 expressly provides devices to deal with such conflicts when they become real rather than potential, by the designation of subclasses. For instance, in *Herbst* v. *ITT, supra,* the District Court declined to disallow a class because of possible differences in the measurement of damages. It noted that, "If it appears at some time in the future that the proper allocation of damages would

be effectuated by the designation of subclasses, it is undisputed that the Court has all the power necessary to implement such a procedure." 65 F.R.D. at 17. The Second Circuit in *Green* v. *Wolf Corporation, supra,* 406 F.2d at 299, observed that:

> "If the trial court finds at some convenient time that a distinction must be drawn between those who purchased at different times, it is free to make use of the flexibility available to it. . . . For example, it may divide the class into subclasses . . . Rule 23(c)(4), or make such other orders as are necessary, Rule 23(d). Compare Harris v. Jones, 41 F.R.D. 70 (D. Utah 1966) in which the Court concluded it could cope with a class action, although the securities in question had been purchased at different times, under varying circumstances, and in response to separate representations, some oral and some written."

What petitioners are really arguing is that the more massive the fraud perpetrated and the longer the time period involved, the more unsuitable the case for class treatment because of inherent conflicts arising from the length of the period and the fluctuations of the price of the stock during that period. To accept their arguments "would encourage corporations to commit grand acts of fraud instead of small ones with the thought of raising the spectre" of conflicts and manageability problems to defeat the class action. *Grad* v. *Memorex, supra,* at 103.

As the Circuit Court accurately noted, petitioners' position with respect to conflicts "depends entirely on adoption of the out-of-pocket loss measure of damages rather than a rescissionary measure". It held that it is within the discretion of the District Judge in appropriate circumstances to apply a rescissionary measure of damages, *Chasins* v. *Smith,*

Barney & Co., 438 F.2d 1167, 1173 (2d Cir. 1970); *Abrahamson* v. *Fleschner*, 392 F.Supp. 740, 746 (S.D.N.Y. 1975); see Note, *the Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities*, 26 *Stan. L. Rev.* 371, 374-376 (1974); Bromberg, Securities Law, Fraud, Rule 10b-5, ¶ 9.1, at 226, or to allow consequential damages, *Zeller* v. *Bogue Elec. Mfg. Co.*, 476 F.2d 795, 802-803 (2d Cir. 1973), which would *per se* eliminate any potential conflict. Moreover, the Court correctly discerned that even if an out of pocket standard applies, conflict can be eliminated at the appropriate time by the creation of subclasses. *Green* v. *Wolf Corporation, supra*, at 299; *Tucker* v. *Arthur Andersen & Co., supra; Handwerger* v. *Ginsberg, supra; In re Caesar's Palace Securities Litigation, supra*, at 398; *Sol S. Turnoff Drug Dist. Inc.* v. *N.V. Nederlandsche Combinatie Voor Chemische Industrie*, 51 F.R.D. 227, 233 (E.D.Pa. 1970); *Hawk Industries, Inc.* v. *Bausch and Lomb*, 59 F.R.D. 619 (S.D.N.Y. 1973).

4. The Circuit Court's Decision Falls Well Within Boundaries Established by This Court with Respect to Section 10(b) and Rule 10b-5 and with Respect to F.R.Civ.P. 23. It does not Enlarge the Class of Persons Intended to be Protected by those Statutes and Rules

The Circuit Court's decision did not break new ground in its application of Section 10(b), Rule 10b-5 or F.R.Civ.P. 23. Thus, this case is entirely unlike *Blue Chip Stamp Co.*, where, in order to impose liability, this Court would have been required to overrule a series of cases stretching back over 20 years, and implicitly endorsed by Congress, which regularly followed the "purchaser-seller" requirement first enunciated in *Birnbaum* v. *Newport Steel*, 193 F.2d 461 (2d Cir. 1952).

The Circuit Court's decision which petitioners ask this Court to review, did not change or extend established law and did not enlarge the class of potential plaintiffs, but limited them to those who have traditionally been found to

be the persons which Congress intended to protect in enacting the federal securities laws.

This case is consistent with *Ernst & Ernst* v. *Hochfelder*, 96 S.Ct. 1375 (1976), for the complaint alleges and the discovery to date demonstrates fraud, and not mere negligence.

This Court has ruled that flexible interpretation of Rule 23 is necessary to insure effectuation of the purposes of litigation efficiency and economy that the Rule, in its present form, was designed to serve. In *American Pipe & Construction Co.* v. *Utah*, 414 U.S. 538 (1974), this Court specifically held the flexible interpretation of Rule 23 was justified in order to effectuate the purposes of the federal anti-trust laws.

While no broadening of Rule 23 was required for class status in the instant action, it is appropriate to note that this Court has on many occasions instructed that the federal securities laws must be enforced flexibly in order to protect the American investing public. This Court has squarely stated, numerous times, that congressional securities legislation enacted for the purpose of avoiding frauds should be construed "not technically, and restrictively, but flexibly to effectuate the congressional purposes". *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963); *Superintendent of Insurance of the State of New York* v. *Bankers Life and Casualty Company*, 404 U.S. 6, 12 (1971). Accord: *Affiliated Ute Citizens* v. *United States, supra.* Identical philosophy was announced by this Court in *Mills* v. *Electric Auto-Lite Company, supra*, at 382-383, where this Court further stated that shareholders should not be discouraged from the private enforcement of the securities rules which "provides the necessary supplement to Commission action", citing *J.I. Case* v. *Borak*, 377 U.S. 426, 432 (1964). The latter case makes it clear that "it is the duty of the court to be

alert to provide such remedies as are necessary to make effective the congressional policy".

As this Court noted in *Ernst & Ernst* v. *Hochfelder, supra,* federal regulation of transactions and securities emerged as part of the aftermath of the market crash of 1929 and was, *inter alia,* designed to provide investors with full disclosure of material information, to protect investors against fraud, and to promote ethical standards of honest and fair dealing. *Hochfelder, supra,* 96 S.Ct. at 1381-82. The fraudulent Ampex financial reporting which is the subject of this lawsuit, which deliberately omitted to disclose serious problems in an effort to artificially inflate income and thus inflate the price of its stock, is precisely the type of activity the federal securities laws in general, and Section 10(b) in particular, were designed to prevent.

Accordingly, it was appropriate that the District and Circuit Courts followed the teachings of this Court in being alert to provide such remedies as are necessary to make effective the congressional purpose. Traditionally, class actions have been an important means of vindicating the congressional policy underlying private enforcement of the federal securities laws. In *Hohmann* v. *Packard Instruments Co.,* 399 F.2d 711 (7th Cir. 1968), the Court, citing its prior decision in *Weeks* v. *Bareco Oil Co.,* 125 F.2d 84, 90 (7th Cir. 1941), reasoned that:

> "to permit the defendants to contest liability with each claimant in a single separate suit would . . . give defendants an advantage which would be almost equivalent to closing the doors of justice to all small claimants. This is what we think the class suit was [intended] to prevent."

The importance of protecting investors and securing compliance with the securities laws has been a repeated factor in decisions by our courts permitting class actions. *Harris* v. *Palm Springs Alpine Estates,* 329 F.2d 909 (9th Cir. 1964); *Green* v. *Wolf Corp., supra; Esplin* v. *Hirschi, supra.* The latter case stated:

> "Since the effectiveness of the federal securities laws may depend in large measure on the application of the class action device, 'the interests of justice require that in a doubtful case . . . any error, if there is to be one, should be committed in favor of allowing the class action' ".

Private securities litigation such as this is now "commonly determined by means of a class action." *Hawk Industries, Inc.* v. *Bausch & Lomb, Inc.,* 59 F.R.D. 619 (S.D.N.Y. 1973). The results in practice have been more than satisfactory. The effect of securities, class action litigation is assessed, as follows, in a Report adopted by the Association of the Bar of the City of New York:

> "The precise effect which class actions have had upon the financial community cannot be measured. It is no overstatement that cases such as *Escott* v. *Barchris Construction Corp.,* 283 F.Supp. 643 (S.D.N.Y. 1968) and *Feit* v. *Leasco Corp.,* 332 F.Supp. 544 (E.D.N.Y. 1971) have had a profound —and beneficial—influence upon the diligence of directors, underwriters, accountants, lawyers and others connected with the public offering of securities." [10]

Effective protection of investors injured by published misrepresentations, and vindication of the public interest in a reliable securities market, require class action certification in cases such as this.

Despite petitioners' hue and cry about an alleged *"in terrorem"* effect of Rule 23, we seriously doubt that the

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[10] Class Actions, Recommendations Regarding Absent Class Members and Proposed Opt-In Requirements. Association of the Bar of the City of New York (1973), p. 16.

petitioners who have agreed to pay $7.75 million in partial settlement of the suit are paying such money for that reason. Their careful avoidance of any real discussion of the facts of the case supports this position. We believe that the merit of their argument was accurately discerned by the Circuit Court. It noted that the limited empirical evidence on the subject indicates that a relatively high proportion of the class actions are not settled, but are disposed of on preliminary motions in defendants' favor. The indication is that if defendants truly believed their proclaimed innocence, their appropriate remedy would be to move for summary judgment. The Court also noted that on the basis of the evidence before it, the Commerce Committee of the United States Senate concluded that the class action was not a particularly effective vehicle for coercing settlement. The Court concluded that the present hue and cry of "blackmail" may in fact merely be "the pained outcry of defendants whose previously advantaged litigating position has been undermined, and who must now confront small claimants (who have been given the capacity to exert pressure proportionate to the magnitude of the total injuries occasioned by defendants alleged violation of the law) on more equal grounds."

Judge Weinstein, formerly a professor of civil procedure at Columbia University Law School and now a district judge who has seen class actions through trial,[11] has sounded the warning that class actions "touch on the credibility of our judicial system. . . . Either we are committed to make reasonable efforts to provide a forum for adjudication of disputes involving all our citizens—including those deprived of human rights . . . and investors who are victimized by insider trading or misleading information—or are not." Weinstein, *Some Reflections on the "Abusiveness" of Class Actions,* 58 F.R.D. 299 (1973).

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[11] See, *e.g., Feit* v. *Leasco Data Processing Equipment Corp.,* 332 F.Supp. 544 (E.D.N.Y. 1971).

Conclusion

Because the Circuit Court's finding of class status falls within established parameters regularly followed by our Courts, breaks no new ground, and at the same time is consistent with this Court's policy of utilization of the class action vehicle as an appropriate remedy for vindicating congressional purpose in enacting the federal securities laws, there is no need for this Court to review the Circuit Court's decision. In addition, dismissal of Touche Ross' § 1291 appeal was proper. Accordingly, the petitions for Writs of Certiorari should be denied.

Dated: New York, New York
June 7, 1976

Respectfully submitted,

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APPENDIX

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(a) 28 U.S.C. § 1291 provides:

"FINAL DECISIONS OF DISTRICT COURTS—The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

(b) 28 U.S.C. § 1292(b) provides in relevant part:

"INTERLOCUTORY DECISIONS . . .

(a) . . .

(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order . . .".

(c) F.R. Civ. P. 23 provides, in relevant part:

"RULE 23. CLASS ACTIONS—(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder

of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (c) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

• • •

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits."

(d) F.R. Civ. P. Rule 23(e) provides:

DISMISSAL OR COMPROMISE. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

(e) Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) provides in relevant part as follows:

Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(f) Rule 10b-5 (17 C.F.R. § 240.10b-5) provides as follows:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

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